Securities Industry
Trends
ANNUAL SUBSCRIPTION
$30.00 member • $48.00 non-member
AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1

Vol. X No. 5 August 22, 1984

SEC RULE 415: BENEFITS AND COSTS FOR EQUITY ISSUERS

HIGHLIGHTS

1. This paper examines the cost of issuing primary equity securities for Rule 415 and non-Rule 415 registrations and trends in the market price of a stock around the announcement date of the stock issue.

2. Using multiple regression analysis, we conclude that issuers that have used the 415 shelf registration procedure experienced lower issuance costs than issuers using non-shelf procedures. These cost savings were substantially more for non-utility issuers than utility issuers.

3. Prices of shelf registered issues perform significantly worse than the market prices of non-shelf issues around the announcement date of the offering. This finding held for both utility and non-utility issuers. During the announcement period, non-shelf issues outperformed shelf issues by almost 9% on a market-adjusted return basis.

4. The negative performance of stock prices of shelf issues was four to twelve times greater than the savings in issuance costs.

5. Price stabilizing activities of an underwriting syndicate may be a very significant benefit to issuers of equity securities.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 608-1500

I. Summary*

In this paper, we examine the effects of SEC Rule 415 on the costs of issuing primary equity securities. Rule 415 permits corporate issuers to register securities with the SEC and then to offer them for sale "off the shelf" on a continuous basis. In this study, the cost of issuing equity securities (underwriting spreads and under- or over-pricing) are compared for Rule 415 and non-Rule 415 issues. The behavior of the market price of a stock around the announcement date of a primary equity issue is also examined.

With respect to Rule 415, we conclude that issuers using the 415 shelf registration procedure have experienced significantly lower issuance costs and underwriting spreads than issuers using non-shelf procedures. However, the prices of shelf registered issues perform significantly worse than the prices of non-shelf issuers around the announcement date of the offering. On average, the negative performance of stock prices of shelf issues overwhelms the savings in issuance costs by four to twelve times. This result is attributed to the inability of a syndicate to perform price stabilization activities and the uncertainty surrounding the timing of a 415 shelf issue.

II. Brief Background

In October 1983, after an 18 month trial period, the SEC permanently adopted Rule 415. This rule streamlines security issuance procedures for issuers that meet certain minimum requirements, enables issuers to avoid using the traditional underwriting syndicate, and creates a more competitive environment among investment banking firms for primary security offerings. In general, temporary Rule 415 was lauded by corporate treasurers but opposed by the investment banking community for equity offerings.

In passing Rule 415, the SEC relied, in part, on an internal Memorandum (see 23) dated September, 1983. The Securities Industry Association, in a critique of the Memorandum prepared by Dr. Jeffrey M. Schaefer (see 20), argued that the SEC Memorandum was flawed. The findings of our study support Dr. Schaefer's position.

---

* The paper is based on research conducted by Dr. Gray for his Ph.D. dissertation. The views expressed are that of the authors and do not necessarily represent the views of E. F. Hutton & Company Inc., the Pennsylvania State University, or SIA.

III. The Sample

Our sample included all underwritten, rated (by Standard and Poor's Corporation), pure equity primary issues offered during the period from March 3, 1982, when Rule 415 was first approved by the SEC, to December 31, 1982. No secondary issues or combinations of primary and secondary issues were included. A minimum offering price of $10/share and a minimum issue size of 250,000 shares was required. An additional requirement for inclusion was that the shares issued were listed on either the New York Stock Exchange or American Stock Exchange.

The data for each issue included in the sample was collected from various sources. The Investment Dealers' Digest was the source for the size of issue, underwriting spread, offering price, issuance date, registration date and registration type. Standard & Poor's Stock Guide was the source of the rating category (A+, A, A-, B+, B, B- or C) and the exchange listing. The Wall Street Journal Index was checked for each offering to determine whether the public announcement of the offering may have preceded its registration. The ISL Daily Market Price Guide was the source for a stock's closing price on the day prior to the offering date. The day prior closing price was used to determine the degree of under- or over-pricing of the offering.

During the period under review, there were 116 offerings included in the sample of which 75 were utility issues and 41 were non-utilities. The 116 offerings consisted of 20 shelf and 96 non-shelf offerings. During the sample period, the Standard & Poor 500 Index rose from 110.92 on March 3, 1982 to 140.64 on December 31, 1982, a gain of 26.8%.

IV. Tests Relating to Underwriting Spreads and Issuance Costs

Rule 415 encourages competition among investment banking firms to manage and underwrite primary equity issues. It also encourages issuers to seek advice from various investment banking firms and to increase their search for the best available prices.

If the issuer and the investment banking community have similar information about the demand for an issue, or if there is greater competition among investment banking firms, or if the cost of underwriter search is smaller under 415 procedures, underwriting spreads and total issuance costs should be reduced.

A. Method of Testing and Variable Specification

The analysis that follows uses multiple regression techniques and is based on methodology and variables used in several empirical studies which have previously examined underwriting spreads and issuance costs (See 14, 16 and 23).

Multiple regression analysis is a simple statistical technique that relates one dependent variable, for example underwriting spread or issuance costs, as a function of several independent variables, for example, size of issue, credit rating, etc. In multiple regression analysis, the researcher attempts to isolate the effects of each of the independent variables on the dependent variable and to determine and quantify relationships among variables.

The independent variables used in our model were: the credit rating of the issuer, the amount of proceeds raised by the issuer, whether the issuer was a utility or a non-utility company, and whether the issue was a shelf registration or a non-shelf registration.

1. Credit Rating

Standard & Poor's credit ratings were included as a measure of safety of the issue with ratings ranging from A+ to C. Zero-one dummy variables were used to represent the credit rating categories. Conceptually, higher-rated securities reflect a lower probability of corporate bankruptcy and are easier to sell leading to lower underwriting spreads and issuance costs.[1/]

2. Proceeds Raised

The amount of proceeds raised was specified in natural logarithm form to capture economies of scale in the issuing and underwriting of securities. Some of the costs incurred by investment banking firms in an offering, such as the advising and origination functions, are roughly the same for small and large issues. Underwriting spreads and issuance costs as a percentage of proceeds raised decline with issue size. The SEC's shelf study measurement of issue size was restricted to three zero-one dummy variables indicating whether the issue size was less than $30 million, greater than $30 million but less than $60 million, or greater than $60 million. In our opinion, this grouping is arbitrary, makes little sense, and is open to question.

3. Utilities Versus Non-Utilities

A zero-one dummy variable was used to specify whether the issuer was a utility or a non-utility. Several studies (see 12, 14 and 18) found significantly lower underwriting

---

[1/] From the reference list, see 7, 14, 17, and 21 for findings in the corporate bond market and 5 for a summary of findings in the municipal bond market.

spreads for bonds issued by utilities than those issued by non-utilities. The SEC's Study (see 23) did not include a dummy variable to examine whether the issuer was a utility or a non-utility. Since the SEC Study contained footnotes of articles noting significant differences in underwriting spreads for utilities, it was a major methodological error not to distinguish between utilities and non-utilities.

4. Shelf Versus Non-Shelf

Theoretically, Rule 415 fosters greater competition among investment banking firms in the primary equity market which should decrease underwriting spreads and issuance costs on shelf registered issues. Two studies, (14) and (18), found this for debt issues while the SEC Study (23), found this for equity issues. A zero-one dummy variable was used to specify whether the offering was shelf or non-shelf registered.

V. Empirical Results

The regression equation and estimates of the values of the independent and dependent variables for underwriting spread and issuance costs are shown in Tables 1 and 2. Underwriting spread and total issuance costs are expressed as a percentage of offering price. Total issuance costs consist of the underwriting spread plus under-pricing (minus over-pricing) where under- or over-pricing is equal to:

$$\frac{\text{Offering price} - \text{Closing price on the previous trade date}}{\text{Offering price}}$$

The signs of the regression coefficients are consistent with our expectations. Underwriting spread and issuance costs generally decrease with higher credit rating and with proceeds raised. If the issuer were a utility, the spread and issuance costs were substantially less than for non-utilities. If the issuer used the shelf registration procedure, costs were less than non-shelf registered issues.

1. Disaggregation into Utility-Non-Utility Sub-Samples

The regression coefficients of the utility-non-utility dummy variable of underwriting spreads and issuance costs were highly negative and significant (t-values of -4.16 and -5.06 respectively), that it was evident that disaggregation of the sample into utility and non-utility sub-samples might be appropriate. A simple statistical test was used to compute the significance levels (t-values) for the difference in the averages of utility and non-utility underwriting spreads and issuance costs. The result substantiated that utility and non-utility underwriting spreads and issuance costs should be analyzed

Table 1

Descriptive Statistics for Multiple Regression Analysis of Underwriting Spreads

Explanatory Variables	Total Sample=116		Utilities=75		Non-Utilities=41	
	Coef.	t-value	Coef.	t-value	Coef.	t-value
Constant	7.066	7.76	3.634	2.72	8.878	9.11
Ln. Proceeds	-0.335	-2.46	-0.138	-0.77	-0.788	-3.74
Utility	-1.044	-4.16	-	-	-	-
Rating:						
A+	-2.633	-2.98	-0.880	-0.69	-3.100	-3.64
A	-2.072	-2.56	-0.599	-0.52	-2.019	-2.69
A-	-1.799	-2.24	-0.253	-0.23	-1.587	-2.07
B+	-1.602	-1.99	0.055	0.05	-1.873	-2.49
B (or lower)	-1.534	-1.89	-	-	-1.824	-2.55
Sale Method Shelf	-0.906	-3.25	-0.681	-2.08	-1.231	-2.26
R^2	.445		.154		.622	
F-Value	10.710		2.060		7.750	
Dep. Mean	3.193%		2.711%		4.075%	
Std. Dev.	1.370		1.141		1.325	
Root MSE	1.059		1.095		0.897	

Regression Equation:

Underwriting Spread = constant + b_{11} (credit rating) +
b_{21} (ln proceeds raised) +
b_{31} [1 = utility, 0 = non-utility] +
b_{41} [1 = shelf, 0 = non-shelf]

Table 2

Descriptive Statistics for Multiple Regression Analysis of Issuance Costs

Explanatory Variables	Total Sample=116 Coef.	Total Sample=116 t-value	Utilities=75 Coef.	Utilities=75 t-value	Non-Utilities=41 Coef.	Non-Utilities=41 t-value
Constant	9.655	7.08	3.086	1.66	11.155	6.48
Ln. Proceeds	-0.381	-1.87	-0.242	-0.98	-0.527	-1.42
Utility	-1.904	-5.06	-	-	-	-
Rating:						
A+	-4.882	-3.70	-0.310	-0.18	-6.378	-4.24
A	-4.050	-3.34	-0.233	-0.15	-4.541	-3.42
A-	-4.161	-3.46	-0.152	-0.10	-4.867	-3.59
B+	-3.952	-3.28	0.113	0.07	-4.935	-3.72
B (or lower)	-3.103	-2.56	-	-	-3.896	-3.08
Sale Method Shelf	-0.746	-1.79	-0.203	-0.44	-2.679	-2.78
R^2	.482		.038		.526	
F-Value	12.420		0.450		5.230	
Dep. Mean	2.916%		1.999%		4.593%	
Std. Dev.	2.122		1.492		2.093	
Root MSE	1.584		1.526		1.586	

Regression Equation:

Issuance Costs = constant + b_{12} (credit rating) +
b_{22} (ln proceeds raised) +
b_{32} [1 = utility, 0 = non-utility] +
b_{42} [1 = shelf, 0 = non-shelf]

separately. The result also raises questions about the specification of the model used in the SEC Study. Accordingly, we examined the data on a total sample basis and a utility-non-utility sub-sample basis.

2. Shelf Versus Non-Shelf Issues

The shelf coefficients in the underwriting spread equation (see Table 1) are -0.906, -0.681 and -1.231 for the total sample, the utility sub-sample and the non-utility sub-sample, respectively. Based on average values of underwriting spreads of 3.193%, 2.711%, and 4.075%, shelf registration appears to have lowered spreads by 28% for the total sample, 25% for shelf registered utilities and 30% for shelf registered non-utilities.

The shelf coefficients in the issuance cost equation (see Table 2) are -0.746, -0.200 and -2.679 for the total sample, utility sub-sample and non-utility sub-sample. The mean issuance costs of the respective samples are 2.916%, 1.999% and 4.593%. Thus, the shelf registration procedure appears to have lowered total issuance costs by 25% for the total sample, 10% for shelf registered utilities and 58% for shelf registered non-utilities. The SEC Study found similar issuance costs savings for a sample of shelf registered equity issues.

3. Comparison of Observed Issuance Costs and Underwriting Spread

It is noteworthy that, in the sample, the total issuance costs for utilities (1.999%) is lower than the underwriting spread (2.711%), while the total issuance costs for non-utilities (4.593%) is higher than the underwriting spread (4.075%). This indicates that investment banking syndicates generally underprice non-utility issues but aggressively price utilities by setting an offering price higher than the last sale price. The over-pricing of utility shares, in effect, subsidizes the higher underwriting spread received by the investment banking syndicate.

VI. Tests Relating to the Reaction of Stock Prices to the Issuance of Primary Equity Securities

A. Theoretical Justification

This section examines how stock prices react to the announcement and issuance of a primary equity offering, and whether the market reaction is different for shelf versus non-shelf issues.

In a perfect capital market (see 9), the price of stocks with lower issuance costs should perform more positively, or less negatively, around the announcement or issuance date (the "event date"), than stocks with higher issuance costs because fewer proceeds are transferred from the issuer to the investment banking syndicate via higher commissions. In a perfect capital market, price stabilizing activities by an investment banking syndicate would be ineffective. Therefore, shelf registrations, with lower issuance costs, should perform better in price trends than non-shelf issues.

Conversely, investment bankers argue that price stabilizing activities have value to the issuer and shelf offerings or competitive offerings do not benefit from such activities, whereas negotiated offerings do benefit from stabilization. If stabilizing activities are effective, then negotiated non-shelf underwritings may outperform shelf offerings around the event dates. A relative negative price performance by shelf offerings when compared with non-shelf offerings, may offset or negate any observed cost savings through the distribution process.

B. Model Specification

The impact of events on common stock returns has been examined in numerous studies in the financial literature. This study examines the average daily price performance of the sample during the 41-day period surrounding the announcement date of the equity issue. We found that essentially all of the abnormal price movements associated with a primary equity issue occurred around the announcement date and not the issuance date (see 8, 11 and 15).

The price performance of the sample was examined on both a raw return and market-adjusted return basis. First, we computed each stock's daily returns for the 41 trading days (days -20 to +20) surrounding the announcement date of the new issue, with the announcement date as day 0. This was done to determine whether any extraordinary behavior was exhibited around the announcement date. An equally-weighted portfolio of all of the stocks in the sample with the 41 daily prices centered on the announcement day was formed. The sample was divided into utility and non-utility sub-samples and further divided into shelf and non-shelf registered sub-samples.

Four (4) time periods within the 41-day announcement period were examined: the pre-event period, which includes days -20 to -2; the event period, which includes days -1 to +1; the post event period, which includes days +2 to +20; and the total event period, which includes days -20 to +20. See Table 3 for a breakdown of the three-day event period only and Table 4 for a breakdown of the entire 41-day announcement period.

Average returns for each sample or sub-sample were computed and the average return characteristics were examined on both a raw percent daily return ("PDR") basis, and a market-adjusted abnormal return ("ARM") basis. The market-adjusted return method uses the model of Charest (4) and Woolridge (23) (the assumption is that each stock has a beta value of 1.0). The market-adjusted daily return is computed by subtracting the daily return of the market surrogate, as measured by the S&P 500 Index, from the observed stock's return. The cumulative measures of the average PDR ("Cumret") and the average ARM ("Cumarm") are examined for each of the four event time periods. The 1982 CRSP Daily Return Tapes were used to track the price performance of each stock around the announcement and issuance dates. Seventeen (17) observations (all non-shelf registrations) issued during December 1982 were dropped from the analysis due to the unavailability of CRSP data to track price performance for twenty trading days after issuance.

C. Results

During the three-day announcement period and the 41-day total event period, the non-shelf sub-samples performed significantly better than the shelf samples on both a raw return and a market-adjusted return basis. See Tables 3 and 4.

There are highly negative mean PDR's and mean ARM's for day -1 for the shelf sub-samples (see Table 3) whereas there are positive mean PDR's and mean ARM's for the non-shelf sub-samples. This may indicate an "information leakage factor" in that corporate financial officers may be calling investment banking firms to solicit indications of interest just prior to official announcement or registration of a shelf offering. Investment banking firms may short the stock, creating downward price pressure on the shares. Such a strategy creates the ability for the shorting firm to aggressively bid for the shelf offering and cover its short position.

The behavior of stock prices during the announcement period for the shelf registered issues for both the utility and the non-utility sub-samples was significantly more negative than the non-shelf issues. During the 41-day announcement period (see Table 4), on average, shelf registered issues had a total raw return of 7.13% while non-shelf issues have a total raw return of 10.59%, a difference of 3.46 percentage points. The disparities in market-adjusted returns are even more apparent with values of -3.07% for shelf issues and 5.70% for non-shelf issues, or a difference of 8.77 percentage points. This negative return performance for shelf issues may be due to uncertainty of timing and syndication surrounding the offering and the inability of a syndicate to stabilize the stock's price during the registration and offering periods.

Due to the small size (20) of the shelf sub-sample, it is difficult to provide conclusive proof of the value of stabilizing activities. Nevertheless, we believe our findings support the following:

Table 3

Summary of the Three-Day Announcement Period Returns for Primary Equity Issues

A. Total Sample:

	Total=99		Utilities=68		Non-Utilities=31	
	Mean PDR	Mean ARM	Mean PDR	Mean ARM	Mean PDR	Mean ARM
Day -1	-0.016	-0.084	-0.012	-0.130	-0.025	0.025
Day 0	-0.882	-1.034	-0.245	-0.489	-2.376	-2.312
Day +1	-0.104	-0.301	-0.168	-0.358	0.048	-0.167
Total	-1.002	-1.419	-0.425	-0.977	-2.353	-2.454

B. Shelf Sample:

	Total=20		Utilities=15		Non-Utilities=5	
	Mean PDR	Mean ARM	Mean PDR	Mean ARM	Mean PDR	Mean ARM
Day -1	-0.795	-1.280	-0.175	-0.956	-2.653	2.253
Day 0	-0.487	-1.207	-0.137	-1.200	-1.536	-1.230
Day +1	-0.631	-0.937	-0.197	-0.635	1.932	-1.843
Total	-1.913	-3.414	-0.509	-2.791	-6.121	-5.326

C. Non-Shelf Sample:

	Total=79		Utilities=53		Non-Utilities=26	
	Mean PDR	Mean ARM	Mean PDR	Mean ARM	Mean PDR	Mean ARM
Day -1	0.187	0.227	0.034	0.013	0.523	0.500
Day 0	-0.985	-0.989	-0.276	-0.288	-2.551	-2.538
Day +1	0.033	-0.136	-0.160	-0.280	0.460	0.183
Total	-0.765	-0.898	-0.402	-0.555	-1.568	-1.855

Table 4

Summary of Pre-Event, Event and Post-Event Announcement Period Returns for Primary Equity Issues

	Total=99		Utilities=68		Non-Utilities=31	
	Cumret	Cumarm	Cumret	Cumarm	Cumret	Cumarm
A. Pre-Event Period (Days -20, -2):						
Overall	6.525	2.946	4.442	1.372	11.410	6.635
Shelf	6.597	0.195	5.425	-0.520	10.113	2.339
Non-Shelf	6.507	3.666	4.164	1.980	11.681	7.530
B. Event Period (Days -1, +1):						
Overall	-1.002	-1.419	-0.425	-0.977	-2.353	-2.454
Shelf	-1.913	-3.414	-0.509	-2.791	-6.121	-5.326
Non-Shelf	-0.765	-0.898	-0.402	-0.555	-1.568	-1.855
C. Post-Event Period (Days +2, +20):						
Overall	4.352	2.369	1.736	0.095	10.328	7.425
Shelf	2.446	0.160	0.031	-0.987	9.691	3.601
Non-Shelf	4.847	2.940	2.218	0.401	10.488	8.445
D. Total Event Period (Days -20, +20):						
Overall	9.876	3.896	5.752	0.490	19.386	11.798
Shelf	7.130	-3.070	4.946	-4.298	13.682	0.613
Non-Shelf	10.589	5.702	5.980	1.845	20.601	14.119

Total Issues=99	Utilities=68	Non-Utilities=31
Total Shelf=20	Utilities=15	Non-Utilities=5
Total Non-Shelf=79	Utilities=53	Non-Utilities=26

Stabilization Hypothesis: all else equal, the performance in the secondary market of a stock's price around the announcement date of issuance will be more positive (or less negative) for an issue that benefits from the price stabilizing activities of a syndicate than an issue not benefitting from such activities.

VII. Conclusion

This paper examined the effects of SEC Rule 415 on the costs of issuing primary equity securities. Rule 415 does reduce underwriting spreads and total issuance costs. On average, equity issues sold through shelf registrations have lower underwriting spreads -- 28% -- and issuance costs -- 25% -- than for comparable non-shelf issues. In the sample, for every $100 raised in a shelf equity issue, the issuer received 74.6 cents more in net proceeds and the investment banking firm received 90.6 cents less in underwriting spread.

The performance of a stock around the announcement date for a primary equity issue was also examined. During the 41-day announcement period, non-shelf registered issues outperformed shelf registered issues by 3.46% on a raw return basis and 8.77% on a market-adjusted return basis.

If a stock is issued during the twenty trading days following the announcement date (the average time from announcement to issuance during the sample period was 17.06 trading days), shelf issues were offered at prices that are, on average, approximately 3.46% lower on a raw return basis and 8.77% lower on a market-adjusted return basis. This is a large price for an issuer to pay to save .746% in issuance costs. In the sample, the negative price performance via the shelf procedure swamps the savings in issuance costs by four to twelve times. This price behavior may be due to the uncertainty surrounding a shelf offering and the inability of investment banking firms to conduct price stabilization activities on the stock being issued.

Gary Gray
Vice President
E. F. Hutton & Company Inc.

J. Randall Woolridge
Associate Professor
The Pennsylvania State University

Reference List

(1) Baron, D.P., (1982) "A Model for the Demand for Investment Banking Advising and Distribution Services for New Issues," The Journal of Finance 37, 955-976.

(2) Baron, D.P. and Holmstrom, B. (1980) "The Investment Banking Contract for New Issues Under Asymmetric Information: Delegation and the Incentive Problem," The Journal of Finance 35, 1115-1138.

(3) Brown, S.J. and Warner, J.B., (1980) "Measuring Security Price Performance," Journal of Financial Economics 9, 205-258.

(4) Charest, G., (1978) "Dividend Information, Stock Returns, and Market Efficiency," Journal of Financial Economics 6, 297-330.

(5) Cook, T.Q., (1982) "Determinants of Individual Tax-Exempt Bond Yields: A Survey of the Evidence," Federal Reserve Bank of Richmond Economic Review 68, 14-39.

(6) Ederington, L.G., (1975) "Uncertainty, Competition, and Costs in Corporate Bond Underwriting," Journal of Financial Economics 2, 71-94.

(7) Fabozzi, F.J. and West, R.R., (1981) "Negotiated Versus Competitive Underwriting of Public Utility Bonds: Just One More Time," The Journal of Financial and Quantitative Analysis 16.

(8) Gray, G. and Woolridge, J.R. (1984) "The Investment Banking Process for Primary Equity Securities and the Effects of SEC Rule 415," Working Paper, The Pennsylvania State University.

(9) Haley, C.W. and Schall, L.D., (1979) The Theory of Financial Decisions, McGraw-Hill, New York, NY.

(10) Hayes, S.L., Spence, A.M., and Marks, D. Van Pragg, (1983) Competition in the Investment Banking Industry, Harvard University Press, Cambridge, Massachusetts.

(11) Hess, A.C., and Bhagat, S., (1983) "A Test of the Price Pressure Hypothesis Using Announcement Data," Unpublished Manuscript.

(12) Johnson, D., (1981) "Interest Rate Variability Under the New Operating Procedures and the Initial Response in Financial Markets," Paper written for the Federal Reserve Staff Review of Monetary Control Procedures.

Reference List (cont'd)

(13) Kessel, R., (1971) "A Study of the Effects of Competition in the Tax-Exempt Bond Market," The Journal of Political Economy 79, 706-738.

(14) Kidwell, D.S., Marr, M.W., and Thompson, G.R., (1983) "SEC Rule 415--The Ultimate Competitive Bid," Unpublished Manuscript.

(15) Korwar, A.N., (1983) "The Effect of Primary Issues of Common Stock: An Empirical Investigation," Unpublished Manuscript.

(16) Logue, D.E., and Lindvall, J.R., (1974) "The Behavior of Investment Bankers: An Econometric Investigation" The Journal of Finance 29, 203-215.

(17) Parker, G.G.C., and Cooperman, D., (1978) "Competitive Bidding in the Uderwriting of Public Utilities," The Journal of Financial and Quantitative Analysis 13.

(18) Rogowski, R.J., and Sorensen, E.H., (1983) "Shelf Registrations and the Cost of Capital: A Test of Market Efficiency," Unpublished Manuscript.

(19) Schaefer, Jeffrey M., "Last Word on Rule 415?" Investment Dealers' Digest, January 31, 1984, p. 3.

(20) Securities Industry Association (1983), "Critique of the Memorandum Prepared by the SEC's Office of the Chief Economist Entitled 'The Rule 415 Experiment: Equity Markets,' " Unpublished Memorandum.

(21) Sorensen, E.H., (1979) "The Impact of Underwriting Method and Bid Competition Upon Corporate Bond Interest Costs," The Journal of Finance 34, 863-870.

(22) Stigler, G.H., (1961) "The Economics of Information," The Journal of Political Economy 69, 213-225.

(23) U.S. Securities and Exchange Commission (1983), "The Rule 415 Experiment: Equity Markets," Unpublished Information Memorandum.

(24) Woolridge, J.R., (1982) "The Information Content of Dividends Changes," The Journal of Financial Research 5, 237-247.

SECURITIES INDUSTRY STATISTICS

VOLUME

	June 1984	YEAR-TO-DATE 1984	June 1983	YEAR-TO-DATE 1983	% CHG. Y-T-D 1984-1983
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	85.9	91.1	89.7	88.1	3.4%
AMEX (MILS.)*	5.1	6.0	10.9	9.5	(36.8)
NASDAQ (MILS.)*	54.9	59.0	79.5	64.6	(8.7)
REGIONAL EXCHANGE (MILS.)* N.A. 8/2					
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	58,433	388,027	73,503	387,136	0.2
AMEX (MILS.)	1,336	10,245	3,794	17,132	(40.2)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5,586	41,238	8,241	47,871	(13.9)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	11,987	80,613	15,138	92,666	(13.0)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	51.2	49.8	43.6	43.6	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	10,183	59,197	6,782	36,335	62.9
AMEX OPTIONS	2,430	17,459	3,337	18,217	(4.2)
COMMODITY	13,209	77,501	9,766	52,014	49.0

* *MONTHLY AVERAGE*

YIELDS
(MONTHLY AVERAGES)

	June 1984	June 1983	Basis Point Change June '84 - June '83
BOND BUYER INDEX (20 BOND)	10.7	9.5	1.2
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	13.55	11.74	1.81
Baa CORPORATE	15.05	13.37	1.68
RATIO Aaa CORPORATES TO Baa CORPORATES	0.90	0.88	--
MUNICIPAL BOND YIELD (MOODY'S)	10.67	8.73	1.94

PRICES
(END OF MONTH)

	June 1984	June 1983	% Change June '84 - June '83
DOW JONES INDUSTRIALS	1132.40	1221.96	(7.3%)
STANDARD & POOR'S 500	153.18	168.11	(8.9)
NYSE COMPOSITE	88.38	97.41	(9.3)
AMEX MARKET VALUE INDEX	200.08	242.32	(17.4)
VALUE LINE COMPOSITE	172.74	204.69	(15.6)
NASDAQ COMPOSITE	239.65	318.70	(24.8)

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	June 1984	Year-to-Date 1984	June 1983	Year-to-Date 1983	% Change Y-T-D 1984 - 1983
NET SALES*	1334.5	9591.5	1930.4	10502.3	(8.7%)
NET PURCHASE OF COMMON STOCK*	377.6	2349.9	1551.4	7346.1	68.0
NET PURCHASE OF OTHER SECURITIES*	3.8	2553.9	274.0	961.4	165.6
MUTUAL FUND CASH POSITION	12.8	---	10.2	---	---

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	June 1984	June 1983	% Change June '84 -June '83
MARGIN DEBT OUTSTANDING ($MILS)	23,450*	17,930	30.8%
NET CHANGE IN MARGIN DEBT ($MILS)	5,520	6,390	13.6
% OF ACCOUNTS WITH EQUITY UNDER 40%	12	8	---

* ALL TIME HIGH

UNDERWRITING
(DOLLARS IN MILLIONS)

	June 1984	Year-to-Date 1984	June 1983	Year-to-Date 1983	% Change June - June	% Change 1984-1983
CORPORATE FINANCING (Gross New Issues)						
Total	11,325	41,851	10,028	61,179	12.9	(31.6)
Common Stock	1,104	5,717	5,239	22,198	(78.9)	(74.2)
# Of Common Stock Issues	65	453	204	744	(68.1)	(39.1)
Preferred Stock	229	2,253	844	5,806	(72.9)	(61.2)
# Of Preferred Stock Issues	4	34	9	79	(55.6)	(57.0)
Corporate Debt	9,993	33,881	3,945	33,175	153.3	2.1
# Of Corporate Debt Issues	46	285	46	377	0	(24.4)
MUNICIPAL FINANCING* (Gross New Issues)						
Total	9,043	51,955	9,951	60,557	(9.1)	(14.2)
Notes	3,291	19,910	3,628	18,705	(9.3)	6.4
Bonds	5,752	32,045	8,359	44,500	(31.2)	(28.0)
# of Bond Issues	353	2,005	893	3,001	(60.5)	(33.2)
Negotiated Bonds	4,295	21,406	5,284	29,715	(18.7)	(28.0)
Revenue Bonds	4,029	19,501	4,667	29,444	(13.7)	(33.8)

*Preliminary Figures

ITEM	DESCRIPTION	SOURCE
"The Federal Reserve Position on Restructuring of Financial Regulation Responsibilities"	Paper presented by Paul A. Volcker to members of the Task Group on Regulation of Financial Services in December 1983. Paper discusses the basic relationship between central banking and supervisory and regulatory responsibilities. In addition, it emphasizes that proposals for administrative reform of supervisory authority need to be viewed in light of proposed substantive changes in governing powers of banks and bank holding companies.	Federal Reserve Bulletin July 1984
F.I.B.V. Statistics 1983	A compilation of data on stock exchanges worldwide. In terms of U.S. dollars and local currencies, data is presented on market activity, market value of listed shares, new listings, and public offerings.	NYSE Economic Research Department
"While the Prairie Parches, the Herd Seeks New Pastures"	View from London of future of Merrill Lynch. Mr. Schreyer has formidable task of transforming his firm into a financial services group fit for the 1990s. Concludes: the odds are stacked against him because, in contrast to the 1970s, ML is no longer in control of its own destiny. Newcomers invading the industry are just as professional and innovative as ML, and customers are more knowledgeable and demanding.	The Economist 7/28/84
"Deregulation & Deposit Insurance Reform"	Bank deregulation has increased the need for deposit insurance reform. In particular, it has enchanced the opportunities for insured institutions to exploit risk-taking incentives in the existing deposit insurance system. Many reform proposals focus on ways of pricing the risk that is not now differentially priced. Author concludes via a comparative analysis of the insurer's liability that the improved monitoring and control of bank activities to prevent insolvency is more important.	Economic Review Spring 1984 Federal Reserve Bank of San Francisco

Securities Industry

Trends

ANNUAL SUBSCRIPTION
$30.00 member • $48.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1

Vol. X No. 6 October 12, 1984

ANALYZING PROFITABILITY, BY FIRM CATEGORY: 1983 AND 1H 1984

HIGHLIGHTS

1. After-tax ROE declined in 1983 for both National Full-Line and Large Investment Banking firms but rose for N.Y. Based Regionals and Regional firms. Profit margins declined for the former two firm categories while rising for the latter ones. In 1H 1984, National Full-Line firms experienced a loss while other firm categories remained profitable although at lower levels. In fact, Regional firms were barely profitable during the 1H 1984.

2. The industry trend of increasing importance of trading profits and decreasing importance of commission revenues continued in 1983 for N.Y. Based Regionals but was reversed for National Full-Line firms. Commission revenues grew at a faster rate for the Large Investment Banks in 1983 than most other firm categories, reflecting their stress on institutional business. In 1H 1984, only the Large Investment Banks enjoyed increased total revenues as revenues shrank for other segments of the securities industry.

3. Cost containment programs were more evident among some firm categories than others as profitability fell in 2H 1983 and in the difficult 1H 1984 period. Overall, controls over expenses were more successful for N.Y. Based Regionals and Regional firms than National Full-Line and Large Investment Banking firms.

4. During 1983, concentration in total revenues and capital lessened in the securities industry. Declining concentration in commission revenues and capital continued in 1H 1984, while concentration in total revenues rose.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 608-1500

Introduction

This Trends report is Part II of a two part issue reviewing the securities industry's performance in 1983 and 1H 1984. Part II analyzes profitability, revenues, and expenses, by firm category. The firm categories examined are National Full-Line, Large Investment Banks, Regional and New York Based Regional. In addition, trends in concentration are discussed.

The industry's performance for 1983 and 1Q 1984 were presented in Part I, the July Trends issue. Also included was an analysis of discounters' profitability and market share. Industry profitability reached record levels during the 1H 1983 but over the next four quarters, higher interest rates caused net income to plummet because of adverse effects on revenues and expenses. As a result, pre-tax annualized ROE dropped from 57% in 1H 1983 to 19% in 2H 1983 and 7% for 1H 1984 (for a detailed summary of revenues and expenses in 1983 see Tables 1 and 2). Recently, published 2Q 1984 data revealed that the industry suffered a loss of $98 million, the first quarterly loss since 4Q 1978 (-$11 million).

Profitability

For the securities industry, after-tax return on equity (ROE) declined slightly in 1983 to 19.8% from 21.9% in 1982. This decline was due to a small drop in profit margin, and a larger fall in asset turnover.1/ Industry leverage increased slightly in 1983. Two firm categories -- National Full-Line (NFL) and Large Investment Banks (LIB) -- followed the industry trend. ROE declined for the NFL firms from 16.1% in 1982 to 15.2% in 1983, and for the LIBs from 29.6% to 23.7% (Table 3). In both cases, the decline was due to a small fall in profit margins and a significant plunge in asset turnover (Table 4).

1/ Profit margin (pre-tax earnings per dollar of revenue) times asset turnover (revenues per dollar of average assets) times leverage (average assets per dollar of average equity) times the tax retention rate (1 minus tax rate on industry) equals after tax earnings per dollar of average equity (ROE).

Table 1

Securities Industry Revenues, Total Expenses And Net Income
(millions of dollars and % of total revenues)

	1983		1H 1984	
	Dollars	% of Total	Dollars	% of Total
REVENUES*				
Commissions				
Listed Equities on an Exchange	$6,129.7	20.7%	$2,665.0	18.6%
Listed Equities Executed OTC	112.3	0.4	35.5	0.2
Listed Options	796.6	2.7	406.0	2.8
Other	1,304.1	4.4	510.5	3.5
Total	8,342.9	28.2	3,617.0	25.2
Trading Profits				
Market Making OTC	1,380.9	4.7	428.9	3.0
Debt Securities	4,417.8	15.0	2,163.6	15.1
Options on Nat'l Exchange	63.6	0.2	31.7	0.2
Other	981.3	3.3	509.3	3.5
Total	6,838.8	23.1	3,130.7	21.8
Investment Profits				
Realized	495.7	1.7	346.6	2.4
Unrealized	178.0	0.6	(106.4)	(0.7)
Total	742.9	2.5	240.3	1.7
Underwriting				
Equity Securities	754.2	2.6	128.9	0.9
Total	3,536.7	12.0	1,175.8	8.2
Margin Interest	2,125.5	7.2	1,450.8	10.1
Mutual Fund Sales	952.0	3.2	343.2	2.4
Account Supervision	569.6	1.9	308.8	2.1
Research	18.7	0.1	9.9	0.1
Commodities	826.1	2.8	410.7	2.9
Other-Related	4,384.1	14.8	2,888.7	20.1
Other-Unrelated	1,207.6	4.1	790.4	5.5
TOTAL REVENUES	$29,544.9	100.0%	$14,366.0	100.0%
TOTAL EXPENSES	$25,721.6		$13,952.9	
PRE-TAX NET INCOME	$3,824.6		$412.9	

( ) Negative

* Discrepencies may exist due to rounding.

Source: Securities Industry Database

Table 2

Securities Industry Expense Breakdown
(millions of dollars and % of total revenues)

	1983		1H 1984	
	Dollars	% of Total Revenues	Dollars	% of Total Revenues
EXPENSES*				
Registered Rep. Comp.	$5,748.3	19.5%	$2,495.1	17.4%
Clerical & Admin.	4,887.6	16.5	2,494.3	17.4
Partners' & Stock.	983.1	3.3	435.0	3.0
Other Employee Comp.	448.5	1.5	213.9	1.5
Floor Brokerage & Clearance	1,142.2	3.9	585.8	4.1
Fl. Brok.-Brokers	389.9	1.3	205.4	1.4
Comm. & Clear.-Others	390.2	1.3	196.1	1.4
Clear. Pd. Non-Brokers	246.4	0.8	128.0	0.9
Comm. Pd.-Other Brokers	115.8	0.4	56.3	0.4
Communications	1,536.7	5.2	878.6	6.1
Occupancy & Equipment	1,137.1	3.8	709.5	4.9
Promotional Costs	734.4	2.5	387.6	2.7
Interest	6,050.6	20.5	4,290.3	29.9
Error Accts. & Bad Debts	232.6	0.8	107.1	0.7
EDP Equipment Costs	342.2	1.2	202.3	1.4
Non-recurring charges	98.5	0.3	3.9	0.0
Regulatory Fees & Exp.	133.7	0.5	69.7	0.5
Other	$2,249.0	7.6	1,080.0	7.5
TOTAL EXPENSES	$25,721.6	87.1%	$13,952.9	97.1%

---

* Discrepancies may exist due to rounding.

Source: Securities Industry Database

Table 3

After-Tax Return on Equity (ROE)

	1982	1983	Annualized 1H 1983	Annualized 2H 1983	Annualize 1H 1984
National Full-Line	16.1%	15.2%	30.8%	1.4%	(9.8)%*
Large Investment Banks	29.6	23.7	29.3	18.7	13.2
N.Y. Based Regionals	23.4	27.3	34.4	21.7	11.0
Regionals	19.4	21.9	31.8	13.0	1.5
Industry	21.9	19.8	30.6	10.3	3.8

---

* Because of 1H 1984 loss, ROE is pre-tax.

The ROE of the N.Y. Based Regionals (NYR) and the Regionals (R) went against the industry trend in 1983, rising from 23.4% to 27.3% and 19.4% to 21.9%, respectively. In the case of the NYRs, virtually all of the increase was due to a substantial improvement in profit margin (14% in 1982 and 18.3% in 1983), with asset turnover nearly unchanged from 1982.

Table 4

Component Analysis of After-Tax Return on Equity

		Profit Margin ($)	x	Asset Turnover ($)	x	Leverage	x	Tax Retention Rate (%)	=	ROE (%)
Nat'l Full Line	1982	.0881		.2681		12.6		54.0%		16.1%
	1983	.0858		.2400		13.7		54.0		15.2
Lg. Invst. Bks.	1982	.1736		.1045		30.2		54.0		29.6
	1983	.1673		.0872		30.0		54.0		23.7
New York Based	1982	.1403		.2257		13.7		54.0		23.4
	1983	.1834		.2267		12.2		54.0		27.3
Regionals	1982	.1108		.3439		9.4		54.0		19.4
	1983	.1265		.4083		7.8		54.0		21.9
Industry	1982	.1308		.1787		17.3		54.0		21.9
	1983	.1294		.1631		17.3		54.0		19.8

Asset turnover rose dramatically for the Rs, from $0.34 of revenue generated per dollar of average assets in 1982 to $0.41 in 1983. Profit margin also rose slightly, from 11.1% to 12.7%. However, offsetting these trends was a decline in leverage (9.4 to 7.8).

ROE deteriorated in 2H 1983 for different reasons for the various firm categories. For the LIBs and NYRs, revenue continued to increase in 2H 1983, but so did expenses -- by about twice as much. For the NFLs, revenues declined in 2H 1983 by $800 million while expenses rose by $200 million. Revenues also declined substantially for the Rs by $170 million, while expenses were nearly unchanged. Nevertheless, average equity continued to rise in 2H 1983 for each firm category. For NFLs, LIBs and Rs, average equity increased by 12.6% - 13.7%; for the NYRs, an impressive 21%.

Revenues

National Full-Line (NFL)

Commissions -- the largest revenue source for the NFL firms -- rose by 35% to $3.6 billion in 1983 reflecting substantial increases in equity prices and volume (Table 5). The spurt in commissions increased the relative importance of this revenue source, reversing a declining trend. During the three year period 1980-1982, commissions as a percentage of gross revenue plunged from over 37% to slightly more than 27%. In 1H 1984, commission revenues fell on an annualized basis by 18.3% from the 1983 level as a result of declines in equity prices and less retail activity. By 1H 1984, the AMEX Market Value Index had declined 10.3% from year-end 1983, the NASDAQ Composite 14% and the S&P 500, 7%.

Table 5

National Full-Line

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/1983
Commissions	$3,628.7	$1,481.8	34.6%	(18.3)%
Trading Profits	2,891.8	1,278.7	26.8	(11.6)
Underwriting	1,592.9	595.8	26.9	(25.2)
Margin Interest	1,100.5	770.2	2.3	40.0
Other-Related	1,524.5	892.1	30.3	17.0
Other-Unrelated	316.0	211.5	(15.9)	33.9
All Other	1,868.7	730.1	99.2	(21.9)
Total	$12,923.1	$5,960.2	30.7%	(7.8)%

Although trading profits rose in 1983 by 26.8%, as a percentage of gross revenue, trading profits declined from 23.1% in 1982 to 22.4% in 1983. This reversed earlier trends where the relative importance of trading profits increased. The flux in revenue sources is evident by this: commissions exceeded trading profits as a percentage of gross revenue by only 4 percentage points in 1982; in 1980, this difference was over 20 percentage points. For the industry, the gap of 15 percentage points between these two revenue sources in 1980 (commissions provided 35% and trading profits 20% of gross revenues) narrowed in 1981 and virtually disappeared in 1982.

Because of interest rate trends in 1982 and 1983, trading profits on debt securities for NFLs increased only 7.4% from 1982 levels. Nearly two-thirds of the $612 million increase in trading profits came from OTC market making. During the 1H 1984, trading profits, on an annualized basis, declined by 11.6% as a result of a continuous rise in interest rates.

Underwriting revenues rose by nearly 27% in 1983 to $1.6 billion, with revenue from equity securities increasing by 83.5% as NFL firms participated in the huge increase in common stock offerings, particularly IPOs. Revenues from debt securities rose nearly 20% due to increased offerings of certain securities -- mortgage backed securities, zero coupon bonds, etc. In 1H 1984, underwriting revenues dropped dramatically -- by 25.2% -- as aggregate corporate equity and debt offerings declined on an annualized basis to $84 billion from $102 billion in 1983, or 18%. IPOs were particularly depressed by falling equity prices, declining 30% and 65% in number and value, respectively.

Margin interest revenues increased slightly (2.3%) in 1983. In prior years (1979-1981), they provided between 17% - 21% of gross revenues. Such revenue rose by a modest amount because of the substantial decline in rates charged customers (from 14.9% in 1982 to 11.4% in 1983),2/ though year-end NYSE customer margin debit balances rose to nearly $18 billion from $12 billion in 1982. As rates charged customers inched up in 1H 1984, margin interest revenue increased by 40% on an annualized basis.

Large Investment Banks (LIB)3/

Commission revenues -- relatively less important to the LIBs than for other firm categories -- increased by 40% in 1983 (Table 6). Commissions increased at a faster rate for LIBs than most other firm categories as institutionalization of trading continued as reflected in the growth of large block transactions (10,000 shares & over) in 1983. Such blocks rose to 45.6% of NYSE share volume from 41% in 1982. With institutional activity falling relatively less than retail activity, LIBs' commission revenues declined by only 5.7% in 1H 1984.

2/ "Securities Industry Performance: 1983 and 1H 1984," Securities Industry Trends, SIA, July 30, 1984.

3/ Data for 1982 are not presented because there was a reclassification of firms for 1983. Included are 1983 and 1H 1984 data.

Table 6

Large Investment Banks

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Commissions	$1,215.9	$ 573.5	(5.7)%
Trading Profits	2,708.2	1,337.4	(1.2)
Underwriting	1,050.6	342.5	(34.8)
Margin Interest	269.4	193.1	43.4
Other-Related	1,984.4	1,549.9	56.2
Other-Unrelated	458.1	283.9	23.9
All Other	522.6	264.9	1.4
Total	$8,209.2	$4,545.1	10.7%

Trading profits in 1983, the most important revenue source for LIBs, remained nearly identical to 1982 because of interest rate trends. As interest rates inched up in 1H 1984, trading profits declined 1.2%.

Underwriting revenue rose 73.2% in 1983, before plunging nearly 35% on an annualized basis in 1H 1984. For LIBs, underwriting activity provided nearly 13% of gross revenues in 1983.

Gross margin interest revenue rose 28.2%, far greater than the industry average of 6.3%, possibly reflecting an emphasis on additional retail accounts at certain LIBs. Other-securities related income -- interest on repos, M&A and private placement fees -- declined by 4.4% for LIBs, while increasing nearly 12% for the industry. In 1H 1984, commissions, trading profits and underwriting revenues were down, but other-related income rose by over 56%.

New York Based Regionals (NYR)[4]

Though commission revenues increased by 41.6% in 1983 for the NYRs, their relative importance declined slightly as gross revenues jumped almost 46% (Table 7). Nevertheless, NYRs continued to derive more of their gross revenues(42%-53%, 1979-1983) from commissions than other firm categories. While commissions were declining in significance in 1983, trading profits increased dramatically (58.7%), and continued to rise in relative importance. Last year, the spurt in trading profits was due mainly to OTC market-making activities.

---

[4] Data for 1982 are not presented because there was a reclassification of firms for 1983. Included are 1983 and 1H 1984 data.

Table 7

New York Based Regionals

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Commissions	$ 794.3	$342.2	(13.8)%
Trading Profits	259.4	93.5	(27.9)
Underwriting	86.9	15.3	(64.8)
Margin Interest	174.5	116.3	33.3
Other-Related	221.7	122.7	10.7
Other-Unrelated	38.4	44.8	133.3
All Other	169.3	85.5	1.0
Total	$1,744.5	$820.3	(6.0)%

Underwriting revenues have been quite volatile for NYRs. For example, underwriting revenues rose nearly 130% in 1983, but declined nearly 65% on an annualized basis in 1H 1984. Both gross margin interest revenue and other-related revenues rose about 20% in 1983, but declined 33.3% and 10.7% on an annualized basis in 1H 1984, respectively. Margin interest revenue continued to be a considerably more important revenue source for NYRs than for other firm categories because of the importance of retail business and many customers having active margin accounts.

Regionals (R)

Commission revenues rose 35.4% in 1983, slightly less than for the industry (Table 8). During 1981-1983, commissions ranged fairly consistently between 36%-39% of gross revenues as compared to 1979-1980 when they provided nearly half of all revenues. In 1H 1984, commissions were off 16% on an annualized basis.

In 1983, trading profits increased by nearly 20%, considerably higher than for the industry, reflecting Rs' greater relative participation in OTC market making activities. However, as securities prices declined in 1H 1984, trading profits, on an annualized basis, declined by 20.4%. In recent years, trading profits have inched up as a revenue source for regional firms providing 16.5% of gross revenue in 1983 after peaking at 18% in 1982.

Table 8

Regionals

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/1983
Commissions	$1,406.2	$ 590.5	35.4%	(16.0)%
Trading Profits	595.6	237.0	19.9	(20.4)
Underwriting	630.5	182.5	70.7	(42.1)
Margin Interest	303.9	215.4	(2.4)	41.8
Other-Related	339.5	171.0	7.9	0.7
Other-Unrelated	72.7	32.6	(3.6)	10.3
All Other	272.4	131.0	37.9	(3.8)
Total	$3,620.8	$1,560.0	29.2%	(13.8)%

Underwriting revenues rose by over 70% in 1983, a much larger increase than for the industry. This reflected Rs' participation in the surge of equity issues and IPOs. Underwriting revenues provide a greater percentage of their total revenues than for all other firm categories. Interestingly, during the 1979-1983 period, the gap between Rs and other firm categories concerning the significance of underwriting revenues widened. During 1H 1984, their underwriting revenues were off 42%, on an annualized basis.

Expenses

National Full-Line (NFL)

NFLs' total expenses in 1983 rose at a slightly faster rate than revenues as the need for cost containment programs was still not evident (Table 9). This differential would have been even greater except for lower average interest rates limiting the rise in interest expense. If interest were excluded, the differential between rising expenses and revenues was more pronounced. For example, non-interest expenses increased 33% while proximate non-interest revenues (excludes margin interest and other-related revenues) rose 30%. Naturally, this trend put pressure on profit margins.

Last year, employment expense accounted for 50% of NFL expenses and was largely responsible for the jump in total costs. Significant increases occurred in both the number of

Table 9

National Full-Lihe

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/1983
Interest	$1,757	$1,327	20%	51%
Employment	6,078	2,814	38	(7)
Registered Rep.	3,451	1,535	41	(11)
Clerical & Admin.	2,627	1,279	34	(3)
Fixed	1,702	1,016	23	19
Communications	923	529	20	15
Occupancy & Equipment	630	394	33	25
EDP Equipment Costs	148	93	6	26
Floor Brokerage and Clearance	362	176	18	(3)
All Other	1,915	848	19	13
TOTAL EXPENSES	$11,814	$ 6,181	31%	5%
TOTAL REVENUES	12,923	5,960	30	(8)
NON-INTEREST EXPENSES	$10,057	$4,854	33%	(3)%
PROXIMATE NON-INTEREST REVENUES	9,806	4,298	30	(12)

employees and average employee compensation (Table 10). Overall, rising employment accounted for about 30% of the jump while higher compensation was responsible for 70%. Among the components, RR compensation accounted for 60% of the climb in total employment expense with 15% occurring because of an expansion in the number of RRs and nearly 45% due to higher compensation. Relative to the remaining employees (includes Non-Registered Representative Income Producing and All Other), higher employment boosted total employment expense 15% while higher earnings caused a 25% increase.[5] It is noteworthy that employment continued rising at annual rates of 11% and 13% in 3Q 1983 and 4Q 1983, respectively, when proximate non-interest revenues and profitability were both dropping.

---

[5] The following methodology was used to estimate the variables responsible for the change in employment expense by type of employee: (1) number of employees and (2) average compensation.

A. For RRs

RN_2 = average number of RRs in 1982
RN_3 = average number of RRs in 1983

RC_2 = average compensation per RR in 1982
RC_3 = average compensation per RR in 1983

ΔEE_3 = change in employment expense in 1983

$\frac{(RN_3 - RN_2)(RC_2)}{\Delta EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 number of RRs

$\frac{(RC_3 - RC_2)(RN_3)}{\Delta EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 RR compensation

B. All Other + Non-RR Income Producing (AO + Non-RR)

ON_2 = average number of AO + Non-RRs in 1982
ON_3 = average number of AO + Non-RRs in 1983

OC_2 = average compensation per AO + Non-RR in 1982
OC_3 = average compensation per AO + Non-RR in 1983

$\frac{(ON_3 - ON_2)(OC_2)}{\Delta EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 number of AO + Non-RRs

$\frac{(OC_3 - OC_2)(ON_3)}{\Delta EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 AO + Non-RR compensation

Table 10

National Full-Line Firms' Employee Expense

	1982	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/83
Average Number of Employees					
Income Producing Registered Representative	36,695	40,565	43,270[2]	11%	7%
Non-RR	1,720	2,045	2,180[2]	19	7
	38,415	42,610	45,450	11%	7%
All Other[1]	61,915	69,965	75,820	13	8
	100,330	112,575	121,270	12%	8%
Average Compensation Per Employee					
Registered Representative	$66,820[3]	$85,075[3]	$70,925[2]	27%	(17)%
All Other + Non RR	30,705	36,480	32,795[2]	19	(10)
	$43,915	$53,990	$46,410	23%	(14)%

( ) - Negative

[1] Includes clerical, administrative and other support employees.

[2] Estimated by SIA.

[3] These average compensations were similar to those for retail RRs which were $62,788 in 1982 and $82,926 in 1983. See: SIA, Report on Production and Earnings of RRs in 1983, p. 13.

Sources: Securities Industry Database and Securities Industry Yearbook.

Fixed expenses rose at a high rate but significantly less than total non-interest expenses. Occupancy and equipment contributed most to the increase followed by communications, while EDP equipment costs remained relatively stable.

In the 1H 1984, cost controls had still not become effective as annualized total expenses continued to rise while revenues were declining. Total expenses were 4% higher than total revenues. A 51% jump in annualized interest expense was the major culprit for this increase. Annualized employment expenses dropped 7% in 1H 1984 as average employee compensation dropped to $46,410, 14% less than 1983.

Annualized fixed expenses continued increasing at a high rate despite the drop in revenues. EDP equipment costs climbed 26%, faster than the 1983 increase. Occupancy and equipment and communications expenses rose 25% and 15%, respectively, reflecting some improvement over 1983.

Large Investment Banks (LIB)

Profit margins deteriorated in 1983 as total expenses rose faster than revenues. This occurred largely due to the adverse impact of higher interest rates on trading profits and other revenue lines. Superficially, the 1983 rise in interest expense appears relatively modest; however, it surged 35% in the 2H 1983 while proximate non-interest revenues declined.

Non-interest expenses climbed significantly faster than proximate non-interest revenues (excludes margin interest and other-related revenues). For 1983, average employment expanded by 2,300 jobs and was responsible for over 40% of the increase in employment costs while about 60% resulted because of higher compensation.

Fixed expenses surged in 1983 and continued to rise even in the 2H 1983 despite falling revenues and profitability. Expectations of future improved business conditions, competitive factors as well as prior contractual commitments contributed to this trend. In 1983, occupancy and equipment and EDP costs each climbed about 45%, while communications rose 24%.

Annualized 1H 1984 total expenses climbed considerably more than total revenues (Table 11). However, these data may not be entirely representative because of the acquisition of Lehman Brothers by Shearson/American Express in 2Q 1984. In such a situation, expenses can escalate temporarily while revenues fall. Interest expense accounted for 90% of the rise in total expenses.

Table 11

Large Investment Banks

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Interest	$3,358	$2,300	37%
Employment	1,905	962	1
Registered Rep.	857	368	(14)
Clerical & Admin.	1,048	594	13
Fixed Expenses	505	307	22
Communications	231	134	16
Occupancy & Equipment	206	132	29
EDP Equipment Costs	68	41	21
Floor Brokerage and Clearance	203	111	9
All Other	865	425	2
TOTAL EXPENSES	$6,836	$4,105	20%
TOTAL REVENUES	8,209	4,545	11
NON-INTEREST EXPENSES	$3,478	$1,806	4%
PROXIMATE NON-INTEREST REVENUE	5,956	2,802	(6)

New York Based Regionals (NYR)

Expense increases were limited during 1983 because of lower average interest rates. Expenses increased less than revenues, resulting in higher profit margins. Interest expense rose only as much as the rise in margin interest revenue and other-related revenues.

Some evidence of cost control is reflected in non-interest expenses which increased significantly less than proximate non-interest revenues. Employment expense is partially related to revenue production which helps explain why it increased faster than non-interest expenses but less than the climb in non-interest revenues.

Evidence that cost controls were in effect is seen in fixed expenses which rose at about one-half the rate of employment expenses. Communications increased least followed by occupancy and equipment and EDP equipment costs.

NYR firms remained profitable during the difficult 1H 1984 because effective cost controls were exercised. Annualized total expenses increased modestly while total revenues were falling (-6%) (Table 12). As a result, expenses as a percentage of revenues rose from 82% to 91%. Higher interest expense was responsible for about 65% of the rise in total expenses.

Table 12

New York Based Regionals

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Interest	$253	$165	30%
Employment	606	283	(7)
Registered Rep.	307	127	(18)
Clerical & Admin.	299	156	4
Fixed Expenses	166	91	10
Communications	74	39	7
Occupancy & Equipment	65	40	22
EDP Equipment Costs	27	12	(11)
Floor Brokerage & Clearance	141	71	0
All Other	259	136	5
TOTAL EXPENSES	$1,425	$746	5%
TOTAL REVENUES	1,745	820	(6)
NON-INTEREST EXPENSES	$1,172	$581	(1)%
PROXIMATE NON-INTEREST REVENUES	1,348	581	(14)

Regionals (R)

Rs' expense performance improved in 1983 because of strong revenue growth, lower interest rates and management controls (Table 13). Total expenses, as a percentage of total revenues, declined from 88.9% to 87.4% from 1982 to 1983. In 1983, non-interest expenses fell as a percentage of proximate non-interest revenues, from 100% to 96%. Employment expenses remained at 55% of proximate non-interest revenues. Apparently, controls were in place as average employment rose only 6% with faster growth occurring in income producing personnel.

Table 13

Regionals

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/1983
Interest	$ 295	$ 211	(5)%	43%
Employment	1,642	721	36	(12)
Registered Rep.	1,034	421	41	(19)
Clerical & Admin.	608	300	29	(2)
Fixed	453	253	21	12
Communications	236	131	17	11
Occupancy & Equipment	167	94	24	13
EDP Equipment Costs	50	28	28	14
Floor Brokerage and Clearance	174	83	28	(4)
All Other	599	275	35	(8)
TOTAL EXPENSES	$3,163	$1,543	27%	(2)%
TOTAL REVENUES	3,621	1,560	29	(14)
NON-INTEREST EXPENSES	$2,868	$1,332	31%	(7)%
PROXIMATE NON-INTEREST REVENUES	2,977	1,174	37	(21)

Cost controls enabled Rs to remain slightly profitable during the 1H 1984 despite poor business conditions which caused revenues to drop 14%. As a result, the pre-tax profit margin fell to 1% as revenues fell while expenses increased. Interest expense rose because of higher rates but this increase was limited as reliance on debt financing decreased.

Revenues from core products such as commissions and underwriting were particularly depressed in 1H 1984 with the result that non-interest expenses climbed to 114% of proximate non-interest revenues. There is reason for concern about long-term adverse effects at firms if expense reductions take place by cutting service muscle as well as fat. Rs did reduce non-interest expenses but not drastically. Annualized employment expense decreased 12% because of a 20% drop in average employee compensation.

Concentration

The expansion in the number of securities firms continued through 4Q 1983 before declining in 1H 1984. The number of NYSE firms doing a public business rose to 405 in 4Q 1983, the highest number since 1975. In the 1H 1984, the number of firms declined to 397 as business conditions deteriorated. As usual, the number of firms entering and leaving the industry reflected changes in market conditions.

During 1983, concentration, as measured by total revenues, lessened for the first time since 1979 (Table 14). It rose in the 1H 1984 with the acquisition of Lehman Brothers and the smaller number of firms. Concentration in commission revenues continued to lessen in 1983 and 1H 1984.

Table 14

Concentration Data, 1979-First Half 1984

	1979	1980	1981	1982	1983	1H 1984
Total Revenues						
Top 10	48.7%	53.1%	55.6%	57.3%	54.4%	57.0%
Top 11-25	18.6	19.4	18.7	18.7	19.6	17.4
Rest of Industry	32.7	27.5	25.8	23.9	26.0	25.6
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Commissions						
Top 10	40.0%	43.6%	43.4%	42.8%	42.0%	41.7%
Top 11-25	20.0	21.1	20.8	20.9	20.8	18.8
Rest of Industry	40.0	35.1	35.8	36.4	37.2	39.5
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Capital						
Top 10	45.8%	50.8%	50.0%	54.8%	52.8%	54.7%
Top 11-25	18.8	18.00	19.7	18.3	18.8	16.6
Rest of Industry	35.4	31.1	30.3	26.9	28.3	28.7
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Securities Industry Database

Concentration in average capital lessened in 1983 and again in 1H 1984. Both subordinated borrowings as well as ownership equity increased at a faster rate for smaller firms than the largest 25 firms. This was attributable, in part, to differences in earnings performances as after-tax ROE was somewhat higher for the rest of the industry than the largest 25 firms during 1983 and 1H 1984. After-tax ROE in 1983 for the largest 25 firms was less than 19% compared to nearly 23% for the rest of the industry. In 1H 1984, annualized after-tax ROE was 3.5% for the former and 4.2% for the latter.

The modest decline in concentration in 1H 1984 was limited by poor business conditions which resulted in mergers and acquisitions as well as the exit of some firms from the industry. Although profitability is expected to improve somewhat in the 2H 1984, the aftermath of 1H 1984 conditions could increase concentration even more.

First Half 1984 Profitability

ROE continued to deteriorate in 1H 1984, and with the exception of the LIBs, at an accelerated rate. The ROE of the NFLs declined to a pre-tax negative 9.8% from 2.6% in 2H 1983. As in 2H 1983, revenues continued to decline and expenses to rise, but by smaller amounts. The 2H 1983 pre-tax earnings of $54 million were completely wiped out by a 1H 1984 pre-tax loss of $221 million. Still, average equity for the NFL firms rose by 7% in 1H 1984.

The ROE of the LIBs was the most resistant to the sharp industry profit deterioration experienced in 1H 1984. Their ROE declined from 18.7% in 2H 1983 to 13.2% in 1H 1984. As in 2H 1983, LIBs' revenues and expenses continued to rise. The 2H 1983 pre-tax earnings of $573 million declined to $440 million in 1H 1984, while average equity for the LIBs rose by 8.2%.

The NYRs saw their 2H 1983 ROE nearly reduced by half in 1H 1984, declining from 21.7% to 11.0%. Unlike the 2H 1983 when both revenues and expenses rose, in 1H 1984 revenues and expenses both declined. Revenues declined by $78 million and expenses by $14 million. Consequently, 2H 1983 pre-tax earnings of $138 million declined to $74 million as average equity rose by 6.3%.

In the 1H 1984, the Rs' ROE declined to 1.5% from 10.3% in 2H 1983. As in 2H 1983, revenues declined much more than expenses -- the difference being $128 million. Consequently, 2H 1983 net income of $145 million declined to $17 million in 1H 1984, while average equity for the regionals rose by 3.2%.

Ira Epstein Assistant Director of Research	Neil L. Shandalow Research Economist

SECURITIES INDUSTRY STATISTICS

VOLUME

	AUGUST 1984	YEAR-TO-DATE 1984	AUGUST 1984	YEAR-TO-DATE 1984	% CHG. Y-T-D 1984-1983
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	110.0**	92.0	74.2	85.3	7.9%
AMEX (MILS.)*	7.5	6.1	6.3	8.9	(31.5)
NASDAQ (MILS.)*	69.3	59.6	54.4	63.3	(5.8)
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	83,299**	522,246	61,555	507,164	3.0
AMEX (MILS.)	2,390	13,906	2,249	22,046	(36.9)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,065	52,247	6,842	61,962	(15.7)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	18,474	111,612	12,203	116,992	(4.6)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.4	49.9	46.7	44.1	-----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	13,338	81,310	6,801	48,668	67.1
AMEX OPTIONS	3,469	23,189	2,868	24,010	(3.4)
COMMODITY	13,201	103,621	10,826	72,382	43.2

* *MONTHLY AVERAGE*

* NEW HIGH

YIELDS

(MONTHLY AVERAGES)

	AUGUST 1984	AUGUST 1983	Basis Point Change Aug. '84-Aug. '83
BOND BUYER INDEX (20 BOND)	10.7	9.7	100
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.87	12.51	36
Baa CORPORATE	14.63	13.64	99
RATIO Aaa CORPS. TO Baa CORPS.	0.88	0.92	--
MUNICIPAL BOND YIELDS (MOODY'S)	9.99	9.04	95

PRICES

(END OF MONTH)

	AUGUST 1984	AUGUST 1983	% CHANGE AUG. '84-AUG. '83
DOW JONES INDUSTRIALS	1224.38	1192.07	2.7
STANDARD & POOR'S 500	166.68	162.14	2.8
NYSE COMPOSITE	95.86	93.80	2.2
AMEX MARKET VALUE INDEX	215.41	230.14	(6.4)
VALUE LINE COMPOSITE	183.28	193.81	(5.4)
NASDAQ COMPOSITE	254.64	290.31	(12.3)

UNDERWRITING
(DOLLARS IN MILLIONS)

	AUGUST 1984	Year-to-Date 1984	AUGUST 1983	Year-to-Date 1983	% Change Aug. - Aug.	% Change 1984-1983
CORPORATE FINANCING (Gross New Issues)						
Total	11,909	59,655	6,180	74,206	92.7	(19.6)
Common Stock	1,094	6,387	3,029	28,566	(63.9)	(77.6)
# Of Common Stock Issues	52	423	156	1,064	(66.7)	(60.2)
Preferred Stock	440	2,907	460	6,678	(4.3)	(56.5)
# Of Preferred Stock Issues	9	50	7	95	28.6	(47.4)
Corporate Debt	10,375	50,361	2,691	38,963	285.5	29.3
# Of Corporate Debt Issues	70	365	43	460	62.8	(20.7)
MUNICIPAL FINANCING* (Gross New Issues)						
Total	10,581	73,009	10,677	81,756	(0.9)	(10.7)
Notes	2,106	25,089	4,101	26,097	(48.6)	(3.9)
Bonds	8,475	47,920	6,576	55,659	28.9	13.9
# of Bond Issues	433	2,971	398	4,147	8.8	(28.4)
Negotiated Bonds	6,798	34,050	4,523	39,186	50.3	(13.1)
Revenue Bonds	6,881	31,773	4,226	38,511	62.8	(17.5)

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	AUGUST 1984	Year-to-Date 1984	AUGUST 1983	Year-to-Date 1983	% Change Y-T-D 1984-1983
NET SALES	2,037.1	12,430.0	808.6	12,827.7	(3.1)%
NET PURCHASE OF COMMON STOCK	2,554.8	4,687.3	932.0	9,425.7	(50.3)
NET PURCHASE OF OTHER SECURITIES	333.6	3,532.8	136.2	1,008.0	250.5
MUTUAL FUND CASH POSITION	11.2	----	8.8	-----	-----

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	AUGUST 1984	AUGUST 1983	% CHANGE Aug. '84-Aug. '83
MARGIN DEBT OUTSTANDING ($MILS)	22,810	19,090	19.5
NET CHANGE IN MARGIN DEBT ($MILS)	3,720	7,940	(53.1)
% OF ACCOUNTS WITH EQUITY UNDER 40%	10	9	-----

UNDERWRITING
(DOLLARS IN MILLIONS)

	AUGUST 1984	Year-to-Date 1984	AUGUST 1983	Year-to-Date 1983	% Change Aug. - Aug.	% Change 1984-1983
CORPORATE FINANCING (Gross New Issues)						
Total	11,909	59,655	6,180	74,206	92.7	(19.6)
Common Stock	1,094	6,387	3,029	28,566	(63.9)	(77.6)
# Of Common Stock Issues	52	423	156	1,064	(66.7)	(60.2)
Preferred Stock	440	2,907	460	6,678	(4.3)	(56.5)
# Of Preferred Stock Issues	9	50	7	95	28.6	(47.4)
Corporate Debt	10,375	50,361	2,691	38,963	285.5	29.3
# Of Corporate Debt Issues	70	365	43	460	62.8	(20.7)
MUNICIPAL FINANCING* (Gross New Issues)						
Total	10,581	73,009	10,677	81,756	(0.9)	(10.7)
Notes	2,106	25,089	4,101	26,097	(48.6)	(3.9)
Bonds	8,475	47,920	6,576	55,659	28.9	13.9
# of Bond Issues	433	2,971	398	4,147	8.8	(28.4)
Negotiated Bonds	6,798	34,050	4,523	39,186	50.3	(13.1)
Revenue Bonds	6,881	31,773	4,226	38,511	62.8	(17.5)

*Preliminary Figures

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	SECOND QUARTER 1984	Yr.-To-Date 1984	SECOND QUARTER 1983	Yr.-To-Date 1983	% Change 2nd Q.1984 2nd Q.1983	% Change 1984-1983
REVENUE						
SECURITIES COMMISSION INCOME	1,642	3,614	2,391	4,503	(31.3)	(19.7)
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,409	3,356	2,028	4,206	(30.5)	(20.2)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	623	1,176	1,003	1,846	(37.9)	(36.3)
TOTAL REVENUE	6,900	14,344	7,973	15,162	(13.5)	(5.4)
TOTAL EXPENSES	6,998	13,945	6,509	12,405	7.5	12.4
NET INCOME BEFORE TAXES	(98)	399	1,464	2,757	---	(85.5)
PERCENT OF FIRMS SHOWING LOSS	50.4	40.8	12.4	9.3	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
"Greenmail: Corporate Takeover Resistance and Shareholder Rights"	Corporate merger activity has resulted in Congressional attention to greenmail. This paper describes current Congressional greenmail legislative activity, legislation and status of legislation. Also included are listings of hearing, reports and documents on greenmail.	Congressional Research Service, Library of Congress, Washington, D.C. 20540 (Order Code IB4112)
"Arbitrage Opportunities: Illusion or Reality"	Yields quoted for mortgage and Treasury securities may not be accurate because of differences in cash flow. Rules of thumb used for mortgage securities result in consistently understating the true yield spread over Treasuries for deep discount mortgage securities and overstating the true yield over Treasuries for premium securities. This article discusses these errors and the process required for investors to calculate the true spread between yields on mortgage securities and Treasury bonds.	Federal Home Loan Mortgage Corp., Secondary Mortgage Markets, August 1984
"Spotting Prepayment Premiums"	Mortgage-backed securities must pay higher yields than noncallable long-term debt instruments. Investors in the former securities must be compensated for the potential losses resulting from prepayments. Mortgage borrowers are willing to pay higher yields because of the prepayment privilege. "The amount investors require above the yield on otherwise identical noncallable securities is known as the prepayment or 'call' premium." A model is presented to calculate the value of the prepayment option.	Federal Home Loan Mortgage Corp., Secondary Mortgage Markets, August 1984
Financial Innovations	Contains papers and discussions presented at the Federal Reserve Bank of St. Louis' seventh annual economic policy conference. The focus of the conference was to examine whether innovations have contributed to or actually impaired the efficiency and stability of financial markets.	The Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, Missouri 63166

ITEM	DESCRIPTION	SOURCE
"Tracking Japan's Deregulation"	Discussed are deregulation changes to Japan's financial system brought on by the metamorphosis in Japan's economic system. The most important actions resulting from the U.S.-Japanese agreement this summer were the liberalization of Euroyen transactions and the removal of the foreign currency swap limits for banks. However, the main component of Japan's new financial system will eventually be market interest rates. Japanese securities firms are competing for deposits and expect to succeed in this area in a deregulated invironment.	Euromoney, September 1984
"Market Share and Profitability: Is Bigger Really Better?"	Corporate strategy generally relates the degree of market share to relative profitability. This relationship was tested two ways. First, it was tested by regressing profitability against market share relative to firms' four digit SIC codes. The statistical support was so weak that strategy based on a relationship between market share and relative profitability should be used with caution. Secondly, regressions were run relating market share to performance for each of 76 industries. The relationship was not significant and nearly one-third of all industries had a negative relationship.	Business Economics October 1984
"Risk Arbitrage"	Discusses the availability of both firms' risk arbitrage research and risk arbitrage services to high commission producing brokers. How brokers use this information is also explained.	Registered Representative, October 1984

Trends AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A9825-1

Vol. XI, No. 1 February 28, 1985

Keys To A Changing Securities Industry

A Summary of Presentations at the 1985 Trends Conference*

The 1985 Trends Conference was structured around a Delphi study of the securities industry in the late 1980s, conducted jointly by SIA and Arthur Andersen & Co. Conference speakers commented on the results of the study and its implications for the securities industry.

The Delphi study surveyed over 600 individuals involved in the securities business, as well as institutional and retail customers. Panelists were asked to make forecasts about: key forces driving change in the industry, structural changes that these forces may cause, and the types of strategic responses that individual firms might expect to make. The study, Keys to a Changing Securities World, raises issues of importance to the securities industry and discusses the possible implications of these issues. It is hoped that the information presented in the study will enable firms to make better informed and more profitable strategic decisions.

This Trends issue summarizes the results of the Delphi study as presented and commented on by industry executives at the Trends Conference.

---

*The full transcript of the 1985 Trends Conference is available at $50. Conference registrants may obtain a copy for $25. An order form is enclosed.

THE SECURITIES INDUSTRY IN THE LATE 1980s

"Delphi Study Results on Future Trends In The Securities Industry: Part I"

Jeffrey M. Schaefer
Securities Industry Association

Key Forces Of Change

Panelists were asked to predict how external forces impacting the securities industry would shape the future. (See Table 1.) Not surprisingly, market trends look favorable. Average daily share volume on the NYSE is projected at 135 million shares in 1988, compared with 91 million in 1984. NASDAQ average daily share volume is projected to climb to 102 million shares by 1988 from 60 million shares in 1984. Trading in most futures and options is expected to rise sharply. Greater activity is projected overall for all markets. Nevertheless, projections represent a slowing down in the actual pace of this activity as compared with the exceptional growth rate of the 1978-83 period.

Despite much recent attention, regulatory changes were not ranked as important as other factors in driving change in the securities business. While most panelists expect a trend toward further deregulation of all sectors of the financial services industry, the regulator and legislator Delphi panelists do not necessarily agree that future changes will be "deregulatory" in nature. As for tax policy, in the summer of 1984, all panelists, except the securities industry, chose the flat rate tax concept as the number one major tax policy change that would best meet sound economic objectives. Securities industry executives singled out the elimination of the double taxation of corporate dividends as the top priority and the flat rate tax as a close second.

Competition is viewed as the number one force of industry change by panelists. For the retail securities business, this competition will stem from nonsecurities firms, with the diversified financial services companies posing the greatest threat. For the institutional business, competition from within the industry itself will be the most intense.

Customer preferences will be the second most important factor for future change. The Delphi survey polled customers as to what they would be seeking from providers of financial services in the future. There are distinct differences between what customers say they want and what providers think they want. Although the securities industry accurately ranked the priorities of money managers, the industry will have to put more emphasis on creativity as far as the corporate customer is concerned. The industry is much more attuned to the needs of retail customers, particulary the $65,000 and over income group, than its competitors. However, neither the industry nor its competitors are aware of the high value customers put on firm image.

Structural Change

Media attention has focused on inter-industry consolidation in recent years. Delphi panelists, however, indicated that intra-industry consolidation would be much more common in the future, with profitability the primary motive for acquisition. Most acquisitions will mimic history. Panelists predicted a compound annual growth rate of 10% for industry capital in the 1984-88 period. In addition, the top 10 firms are expected to increase their revenue share at the expense of the firms below the top 25.

The industry's revenue mix will be different in 1988 than it is today and today is very different than five years ago. While commissions become relatively less important, trading and investment will become more important, continuing a trend of increased reliance on principal business. Moreover, the investment banking business is expected to continue increasing in relative importance.

Table I

Overall Ranking of the Future Impact of the Major Forces of Change

Forces of Change	Retail Business	Institutional Business
Competition Among Securities Firms	3	1
Competition From Non-Securities Firms	1	4
Customer Preferences	2	2
Deregulation/Reregulation	4	5
Economic Factors	5	3
Tax Policy	7	7
Technology	6	6

"Delphi Study Results on Future Trends In The Securities Industry: Part II"

Marc H. Sternfeld
Arthur Andersen & Co.

The Delphi study panelists are predicting a slowdown in the expense increases of the past five years in categories such as occupancy and clerical costs. However, two categories of non-personnel costs that are expected to increase significantly are data processing and communications expenses. Not surprisingly, therefore, cost control was singled out as the most important factor affecting profitability of securities firms in the late 1980s. Moreover, a theme running through panelist responses is that the industry will continue to move away from the concept that all firms must offer all products to all customers. There appears to be a move toward more specialization in markets or products.

Based on gross activity forecasts for 1988, internationalization of markets will continue, with U.S. interest in foreign equities expected to outpace the increase of foreign interest in U.S. equities. Panelists believe that foreign companies will enter the U.S. market via joint ventures with U.S. investment banks and that U.S. firms will expand foreign offices.

Firm Response to Change

Firms will be targeting the same customers -- individual investors with incomes of $80,000 plus and middle market companies. Marketing will, therefore, become increasingly important. In terms of components of marketing, panelists indicated that they will be more aggressive in bringing products to markets. Input from the sales force will remain the industry's number one influence on product development. Although marketing's share of total expenses is predicted to increase dramatically, marketing was ranked low in influence on profitability. Evidently, the securities industry is still skeptical as to the affect of marketing on the bottom line.

Who will have the competitive advantage in the basic financial service products? There was almost universal agreement among the panelists that the securities industry will have the advantage in underwriting, trading, and research services. Banks, on the other hand, will have the advantage in discount brokerage, transaction-oriented activities and credit products. However, in financial planning, neither securities firms nor banks are expected to have the advantage.

The role of the account executive is expected to evolve into that of a financial advisor supported by salaried experts. However, competitors indicated that there will be less importance on the account executive, suggesting that they will try to offer a service less dependant on personal relationship and more dependant on technology. Direct mail is seen as the most popular alternative distribution method.

Panelists predict greater resource allocation to technology. Reduction of costs will be the major influence on technology expenditure decisions. Nevertheless, despite projected commitment to technology, neither the securities industry nor its competitors believe it is vital to the success of their firms. The top three critical success factors for a securities firm in the late 1980s were: management skills, identifying niches, and attracting and retaining quality people.

MANAGEMENT STRATEGIES TODAY AND TOMORROW

"Opportunities and Concerns of the 1980's"

George L. Ball
Prudential-Bache Securities Inc.

There are several factors which would seem to omen gloom for the securities business: dimished retail stock market participation, the likelihood of reduced institutional rates, increased probability of bank entry into the corporate investment banking sector, and continued volatility in the fixed income markets. Moreover, there are high fixed costs, proposed tax reforms that could dramatically impact tax-shelter sales, and the increasing unwillingness of investors to pay high rates for average results.

Nevertheless, there are some potentially positive aspects to what may appear as a hostile future environment. According to a recently conducted strategic survey by Pru-Bache, the retail investor has not vanished but has become increasingly selective as to when he or she participates in the stock market. Indeed, affluent households, those with incomes of $50,000 and above, are a rapidly growing sector and are expected to save more via IRAs, Keoghs, etc. in the future. Moreover, the number of affluent individuals in the wealth-accumulation phase of their life cycles, ages 45-55, is expected to grow by 53% between now and 1990. About 88% of these individuals say a skilled financial advisor will be an absolute necessity. For firms that create and deserve an image of being skilled and trusted, this presents a tremendous opportunity. Finally, the survey showed that corporations are going to need more external capital in years ahead.

From a strategic point of view, it's clear markets have changed. In other words, fans have not changed, they are simply not drawn to the ballpark by the same old game. Firms must devise new ways to bring fans back to the stadium. The securities industry should start marketing equities -- the bread and butter of the industry which has been neglected for too long by diversification-minded firms. In that respect, the failure of the industry to use its skills has been in part responsible for the withdrawal of the retail investor from the marketplace.

The key to the future lies in better investment ideas development, research and training. The vistas of financial planning are far better and broader today than a few years ago. To the extent that a disciplined and thoughtful approach to markets typifies a firm's account executives, victory is achievable. Improving AE investment acuity, however, requires that management itself become actively involved in the identification and articulation of exciting investment opportunities.

"Controlling Costs: Problems & Opportunities"

Benjamin F. Edwards
A.G. Edwards & Sons, Inc.

Delphi panelists believe that controlling costs is the number one influence on profitability. (See Table 2.) At A.G. Edwards, controlling costs is an attitude that has been developed on a firmwide basis. First, a common firm goal was established -- what type of firm to be, what markets to approach and how to do it. A consistent compensation system was implemented whereby no one, with the exception of the investment broker, has ties to gross revenues. Since bonuses are paid out of overall firm profits, each department's efforts are dedicated to serving the investment broker and client.

Table 2

Ranking of Profitability Factors

Factors	Securities Firm CEOs	Competitor CEOs
Cost Control	1	1
Customer Service	2	2
Perceived Quality of Products/Services	3	5
Marketing	4	3
Uniqueness of Products/Services	5	6
Pricing	6	4

Source: Keys to a Changing Securities World

In the 1970s, A.G. Edwards learned that cost control can be a very painful challenge. Over confidence fostered by the boom period of the late 1960s had permitted expenses to grow uncontrollably. In April 1970, the firm projected that it could lose money at the same rate for about five months before going under. This drastic forecast called for drastic action.

Executive salaries were cut for the third time and everyone else's also. A 10% cost cut was thought necessary. However, given high fixed costs, this translated into a 20% cut in human costs. Each department was directed to cut costs as best they could. To management's astonishment, every department except one made cuts larger than 10%. The creativity demonstrated on a firmwide basis included the establishment of the "Scotch week," whereby individuals voluntarily worked a shorter week in lieu of being laid off.

Controlling costs also involves knowing what type of business a firm wants to be in. A.G. Edwards has, thus, concentrated mainly on the brokerage business and diversified only insofar as they felt their sales force could handle it. Vertical integration, the manufacturing of products, has been resisted for a two-fold reason: the threat of losing objectivity in giving investment advice and the avoidance of higher fixed costs.

A.G. Edwards believes in giving considerable responsibility to each department manager as it results in higher quality business decisions. As these individuals are intimately involved in the everyday operations of the firm, they are often best qualified to make a decision involving their department's function. A Job Operation Improvement program has also been implemented that allows 15 people from various positions in the firm to work jointly on cost-controlling ideas. While both small and large factors contribute to controlling costs, at A.G. Edwards the single most important factor in cost control is people.

DELPHI STUDY IMPLICATIONS FOR SPECIFIC BUSINESSES

"The War for Institutional Commissions"

James Balog
Drexel Burnham Lambert Inc.

Commission rates are coming down, while costs for personnel and new technology are going up. The "third party" business -- the practice of giving back to institutions a part of the commission that pays for research, custodian fees and other services ordered by money managers and pension plan sponsors -- puts a further squeeze on the commission dollar. Despite this squeeze, less than 5% of industry respondents in the Delphi study believe firms will abandon research departments. Why? The answer lies in the fact that research is important to institutions, and the institutional equity business is the lynchpin of the structure of most major firms.

What makes the business so volatile? Soaring fixed costs coupled with large capacity in the institutional end of the business. While higher volumes support the industry in the good times, rates get chopped in slow times. The diversion of some volume to the third-party business has exacerbated problems. A 25%, and possibly as much as 40%, slice of the $3 billion institutional commission pie is being used by money managers to pay for third-party research. A recent permutation in the third-party business is the direction of commissions by plan sponsors.

Even regulatory intervention into some abuses in the third party area will not roll the clock back to the 1960s. As a consequence, the securities industry will shift its capital use to more proprietary trading. Other steps taken may mean that more of the research department's time will be used for in-house purposes. More rational compensation schemes for all -- analysts, salesmen and traders -- are under way. New entrants to the securities business may even finance greater competition for the institutional commission dollar. However, it's well to remember that the law of supply and demand operates for both old participants and new challengers.

"The Retail Securities Business"

Peter F. Muratore
E.F. Hutton & Company, Inc.

All Delphi panelists predictably suggest that competition will continue to be the driving force of change in the securities industry. However, the real value of the Delphi study lies in the predictions of competitors, observers, and others for the securities industry. Our own understanding of the securities industry coupled with an understanding of how competitors and others view the industry should provide the basis for industry response to future change.

The securities industry must keep in mind that nearly every investor has multiple client relationships and that our competitors may not necessarily be trying to take our clients away from us, but rather expanding their ties to their own long-term clients by recognizing more of those client needs. One advantage that securities firms have in meeting future competition is the strength and value of personal relationships. The industry's response to increased competition could be a greater focus on service, greater personal attention to clients, and more information flow related to the client's specific needs as an investor.

The projected growth of equity-based services leads to another important Delphi finding: the role of the account executive could evolve to that of a financial advisor, assisted by salaried personnel with expertise in specialized areas. If, in fact, this develops, what new training programs should be put in place to support him? What compensation structure would be appropriate? The study easily leads us to imagine the development of multi-tiered sales forces as well as much greater use of non-personal sales tools, such as direct mail and other new, easy-access technologies.

The most critical factor contributing to the profitability of securities firms in the late 1980s is expected to be cost control, with the industry indicating that they will focus on technology and increased employee productivity in their efforts to control costs. Competitiors will use technology to create new products, while the industry will use technology, first, to keep current customers and, second, to reduce costs. Technology, however, can be a two-edged sword, and the industry seems to have confused perceptions of what it can do. This suggests that the industry needs a very clear picture of what clients it wants to keep or acquire and what technologies will help serve them better and more efficiently.

In reviewing customer preferences, the most important implication in the Delphi report is that securities firms must make a concentrated effort to be more informed about customer values. Yet, both the securities industry and its competitors rank direct customer information as the least important influence on product development. (See Table 3). More focused market research and market planning are absolute keys to the future. If the industry does not know what customers want and

Table 3

Ranking of Product Development Influences

Factors	Securities Firm Senior Management	Competitor CEOs
Sales Force Feedback	1	3
Recognition of Market Need	2	1
Introduction of a Product by a Competitor	3	2
Direct Customer Information	4	4

Source: Keys to a Changing Securities World does not provide a comfortable environment for customers to make investment decisions, we can be sure that our competitors will.

"The Origination & Distribution of Securities"

Professor Samuel L. Hayes, III
Harvard University
Graduate School of Business Administration

There are several factors that are important for the future course of the investment banking business. These are: globalization and institutionalization of markets, increased volatility, growing demands for capital, sophistication of customers, and competition from firms traditionally outside the securities business. These factors have not only shaped the working environment, but led to additional forces of change. For example, many "synthetic" securities have been devised to meet changing markets and issuer demands. In addition, there has been a movement toward de facto competitive bidding underwriting, with Rule 415 playing an important role.

For the wholesale investment banking firm, these changes mean the firm must be prepared to be represented in a wide variety of markets -- geographic, product, and maturity markets. Trading will take on particular importance in the future, as firms will be required not only to create new instruments but to provide the liquidity necessary to make those instruments attractive to a variety of investors.

There will be some fragmentation of investment banking relationships in the future, with corporate CFOs doing ad hoc shopping for creativity and the ability to deliver on that creativity. (See Table 4.) Nevertheless, traditional relationships will not be "out the window" as CFOs will continue to want a "life line" to the investment banking community. Professor Hayes believes that the leading wholesale firms have taken measures necessary to protect their leading position in the investment banking business. Thus, it will be very difficult for other securities firms to gain a leading edge in the wholesale market and even more difficult for outsiders to enter the business.

Professor Hayes finds the issue of due diligence as related to Rule 415 offerings troublesome. Of the 1,400 S3-reporting firms, only the largest, constituting a narrow range, have used shelf registrations thus far. When other companies in this qualifying group begin to use shelfs, there could be reluctance on the part of the investment banks to bid on the offering. The end result may be some innovative and creative developments, such as the farming out of the due diligence requirements to a third-party insurer.

Table 4

Changing Priorities of Corporate Underwriting Clients

Panel	Prior Relationship		Creativity	
	Now	Future	Now	Future
Securities Industry	1	2	4	3
Corporate CFOs	1	4	3	1
Competitors	1	2	4	4

Source: Keys to a Changing Securities World

Where will investment banking firms continue to derive large revenues from? Classic underwriting revenues may not be sustained in the future, and competition for M&A business in the middle market will be very intense. As is true for securities firms in general, the large investment banks have to support large fixed costs. Thus, Professor Hayes believes that, as investment banks increasingly develop into large, almost corporate-like organizations, the wholesale boutique, where there is low overhead and highly motivated individuals, may find a viable niche.

Carolyn Hildebrandt
Assistant Vice President

SECURITIES INDUSTRY STATISTICS

VOLUME

	DECEMBER 1984	YEAR-TO-DATE 1984	DECEMBER 1983	YEAR-TO-DATE 1983	% CHG. Y-T-D 1984 - 1983
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	89.0	91.1	88.0	85.4	6.7%
AMEX (MILS.)*	7.3	6.1	6.9	8.2	(25.6)
NASDAQ (MILS.)*	64.6	59.9	63.2	62.8	(4.6)
REGIONAL EXCHANGE (MILS.)*					
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	56,449	764,738	63,770	765,276	(0.1)
AMEX (MILS.)	1,573	21,466	1,814	30,136	(28.8)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	4,688	70,459	6,517	87,854	(19.8)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	14,475	167,086	14,082	168,303	(0.7)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	46.8	49.8	49.9	45.6	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	9,823	123,274	9,578	82,469	49.5
AMEX OPTIONS	3,509	40,105	3,405	38,667	3.7
COMMODITY	9,765	149,372**	9,926	139,925	6.8

* *MONTHLY AVERAGE*

** NEW HIGH

YIELDS
(MONTHLY AVERAGES)

	DECEMBER 1984	DECEMBER 1983	Basis Point Chg. Dec. 84- Dec.83
BOND BUYER INDEX (20 BOND)	9.9	9.9	0
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.71	12.57	14
Baa CORPORATE	14.19	13.75	44
RATIO Aaa CORPORATES TO Baa CORPORATES	0.90	0.91	--
MUNICIPAL BOND YIELD (MOODY'S)	10.10	9.34	76

PRICES
(END OF MONTH)

	DECEMBER 1984	DECEMBER 1983	% CHANGE Dec.84 - Dec.83
DOW JONES INDUSTRIALS	1211.57	1258.64	(3.7)
STANDARD & POOR'S 500	167.24	164.93	1.4
NYSE COMPOSITE	96.38	95.18	1.3
AMEX MARKET VALUE INDEX	204.26	223.01	(8.4)
VALUE LINE COMPOSITE	177.98	194.35	(8.4)
NASDAQ COMPOSITE	247.35	278.60	(11.2)

UNDERWRITING
(DOLLARS IN MILLIONS)

	DECEMBER 1984	Yr.-To-Date 1984	DECEMBER 1983	Yr.-To-Date 1983	% CHANGE Dec. - Dec.	% CHANGE 1984 - 1983
CORPORATE FINANCING* (Gross New Issues)						
Total	6,080	82,177	5,516	102,406	10.2%	(19.8)%
Common Stock	686	8,922	1,968	39,122	(65.1)	(77.2)
# Of Common Stock Issues	36	557	131	1,633	(72.5)	(65.9)
Preferred Stock	90	3,932	371	8,670	(75.7)	(54.6)
# Of Preferred Stock Issues	4	70	9	132	(55.6)	(47.0)
Corporate Debt	5,303	69,323	3,177	54,614	66.9	26.9
# Of Corporate Debt Issues	56	784	42	643	33.3	21.9
MUNICIPAL FINANCING* (Gross New Issues)						
Total	12,329	123,876	11,114	119,196	10.9%	3.9%
Notes	695	30,539	1,977	35,848	(64.8)	(14.8)
Bonds	11,634	93,337	9,137	83,348	27.3	12.0
# of Bond Issues	367	5,332	478	6,290	(23.2)	(15.2)
Negotiated Bonds	9,729	70,913	6,316	59,652	54.0	18.9
Revenue Bonds	9,354	66,959	6,770	58,780	38.2	13.9

*Preliminary Figures

These tables were prepared by Karin Ford

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	DECEMBER 1984	Year-To-Date 1984	DECEMBER 1983	Year-To-Date 1983	% Change Y-T-D 1984 - 1983
NET SALES	1,255.2	17,248.4	1,350.1	18,162.9	(5.0)%
NET PURCHASE OF COMMON STOCK*	114.5	4,432.2	751.1	12,651.9	(65.0)
NET PURCHASE OF OTHER SECURITIES*	647.3	9,458.5	498.2	2,613.0	262.0
MUTUAL FUND CASH POSITION	10.6	----	8.8	----	-----

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	DECEMBER 1984	DECEMBER 1983	% CHANGE Aug.84 -Aug.83
MARGIN DEBT OUTSTANDING ($MILS)	22,470	22,720	(1.1)%
NET CHANGE IN MARGIN DEBT ($MILS)	(250)	9,740	(102.2)
% OF ACCOUNTS WITH EQUITY UNDER 40%	11	10	------

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	THIRD QUARTER 1984	Yr.-To-Date 1984	THIRD QUARTER 1983	Yr.-To-Date 1983	% Change 3rd Q.1984 3rd Q.1983	Yr.-To-Date % Change 1984 - 1983
REVENUE						
SECURITIES COMMISSION INCOME	$1,760	$5,379	$1,981	$6,482	(11.1)%	(17.0)%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,332	5,702	1,712	5,921	36.2	(3.7)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	659	1,835	872	2,724	(24.4)	(32.6)
TOTAL REVENUE	8,308	22,681	7,149	22,317	16.2	1.6
TOTAL EXPENSES	7,617	21,577	6,407	18,812	18.9	14.7
NET INCOME BEFORE TAXES	691	1,104	742	3,505	(6.9)	(68.5)
PERCENT OF FIRMS SHOWING LOSS	30.9%	38.7%	24.3%	9.8%	----	----

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Keys To A Changing Securities World	Delphi study of securities industry in the late 1980's, on which this *Trends* issue is based.	Communication Services (KCS4AF) Arthur Andersen & Co. 69 West Washington St. Chicago, Illinois 60602 $50 SIA members; $75 others
"Bank Entry Into Securities Brokerage: Competitive And Legal Aspects"	Four-part article reviews: structure and behavior of the securities industry since 1975; goals and operations of bank securities brokers; legal and regulatory aspects of bank securities brokerage; and public policy implications of bank entry into securities brokerage. Article concludes: So long as banks offer new services from an impartial position, as agent for customers, and with no principal interest in particular securities, it would be anticompetitive and inefficient not to allow the national process of innovation to proceed.	*New England Economic Review* Federal Reserve Bank of Boston November/December 1984
"Structural Change And Slower Employment Growth In The Financial Services Sector"	New York City's post-1978 economic revival has been largely due to rapid employment growth in the banking and securities industries. These industries account for 40% of the new jobs created in the city since the turnaround began. In the future, total U.S. employment in these industries is likely to grow much more slowly, but NYC's financial services sector may fare somewhat better than the U.S. as a whole. Article reviews reasons for rapid growth and expected slowdown, with special focus on NYC.	*Quarterly Review* Federal Reserve Bank of New York Winter 1984-85

ITEM	DESCRIPTION	SOURCE
The Financing And Regulatory Capital Needs of The Securities Industry	Report describes the net capital and other financial responsibility rules, the reasons for their enactment, and their evolution over time. It examines how the capital needs of the securities industry have been affected by trends in the industry's financial structure and regulations, and analyzes the financing and regulatory capital needs of various kinds of broker-dealers. For example, the report shows how the rules place different capital requirements on broker-dealers, depending upon which of two measures of capital adequacy is used. The SEC published the report to assist commentators who may wish to respond to the various policy issues raised in a recent release (No. 34-21651) on the future course of the financial responsibility rules for broker-dealers.	Directorate of Economic and Policy Analysis SEC 450 Fifth Street Washington, D.C. 20549
Economic Report Of The President	Report of the President along with the Annual Report of the Council of Economic Advisers reviews the progress of the economic recovery program in 1981-84 and gives the outlook for 1985-90. Major chapters include: The Federal Budget and the Economy, The United States in the World Economy, and The Market for Corporate Control. Detailed statistical tables relating to national income, employment, and production, with many dating back to start of collection effort, 1929.	Superintendent of Documents U.S. Government Printing Office Washington, D.C. 20402
Comparison of Current Tax Law, Bradley-Gephardt, and Kemp-Kasten Tax Bills	Three page table prepared by the CBO comparing major provisions affecting individuals and business.	Bureau of National Affairs, Taxation and Accounting 1/31/85

Securities Industry Trends

ANNUAL SUBSCRIPTION
$36.00 member • $60.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1

Vol. XI, No.2 April 30, 1985

The 1984 Performance of the Securities Industry

Highlights

1. Industry after-tax ROE dropped to 7.2% in 1984, the lowest level since 1977. The ten firms categorized as Large Investment Banks (LIBs) received 72% of the industry's pre-tax income. Excluding the LIBs, the industry's after-tax ROE was a disappointing 2.9%, after averaging nearly 21% from 1979-1983.

2. Commissions fell 15% to $7.1 billion in 1984 and accounted for only 23% of total revenues, the lowest percentage recorded since such data were tabulated by the regulatory organizations.

3. Trading profits increased 11% in 1984 to a record $7.5 billion and were, for the first time, the largest revenue source on an annual basis.

4. Underwriting revenues dropped 24% in 1984 to $2.7 billion largely because of a 67% plunge in revenues from underwriting equity securities.

5. Employment expenses declined 3% in 1984 because management exercised controls to limit both employment and salary increases while RR compensation fell due to the drop in RR production.

6. Concentration in total revenues and capital increased for the Top 10 firms as two of the larger firms in the Top 11-25 firms in 1983 were acquired in 1984 by firms in the Top 10.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 608-1500

Introduction

This issue of Trends analyzes the securities industry's 1984 performance in the aggregate including the economic environment, profitability, revenues, expenses and concentration. Profitability and other trends in 1984 by firm category will be examined in a forthcoming Trends issue.

1984 Economic Environment

The profitability of the securities industry is usually closely correlated with the current and future economic environment . However, this was not the case last year. In 1984, the overall performance of the economy was very strong. Real GNP rose 6.8%, the largest gain since 1951, prices increased only 3.8% and civilian employment expanded by 4.2 million. However, monetary authorities were still concerned about a resurgence of inflation because of a fiscal policy considered expansionary. Whenever economic growth accelerated, monetary policy was tightened to prevent a resurgence of inflation. As a result, there was volatility in the economy's performance on a quarterly basis. In addition, there was uncertainty about future economic trends which affected the securities markets unfavorably. High interest rates and uncertainty emanating from the conflict between monetary and fiscal policies affected securities prices and industry profitability adversely.

First Quarter

During the first quarter, it was difficult to guage the pace of economic growth. Strong growth was reflected in residential and nonresidential investment and consumer durables but some key preliminary indicators such as retail sales and GNP initially pointed to only a moderate increase. Later, significant upward revisions were made to these indicators. Real GNP growth was finally reported as climbing an impressive 10.1%.

Interest rates declined until mid-February but then rose during the rest of the quarter because of rapid growth in the monetary and credit aggregates and Treasury borrowings of $47 billion. Market participants remained pessimistic about the outlook for interest rates and feared a conflict between government and private credit demands given the size of the deficit. The Federal funds rate rose from 9.0% to 9.6%, and the 30-year government bond rate went from 11.8% to 12.5%. The pessimistic interest rate outlook hurt the stock market and the Dow Jones Industrial Average fell from 1259 to 1165.

Second Quarter

Economic expansion continued at a fairly rapid pace as real GNP rose by 7.1%. Most sectors contributed to this increase including consumers, nonresidential and residential investment, business inventories and government spending. However, agricultural and oil related industries as well as export related industries did poorly. The strong U.S. dollar caused the trade deficit to remain at a record level. Civilian employment rose by nearly 1.3 million; the unemployment rate dropped to 7.2%; and inflation declined to 3.3%.

Interest rates continued to rise. The Federal Reserve tightened monetary policy in light of the significant increase in economic growth. The discount rate was raised from 8.5% to 9.0%. Continental Illinois National Bank and Trust Company of Chicago was not able to fund itself in May and had to rely on the Federal Reserve's discount window for funds. The Federal Reserve drained reserves in other ways to offset reserves lent to Continental Illinois. Banks began to hoard reserves to protect themselves. Also contributing to higher interest rates was the Treasury's borrowings of $30 billion and continued fear of a collision over financing needs between the public and private sectors. The Federal funds rate jumped above 11% and the rate on 30-year Government bonds climbed to nearly 14%. As a result, stock prices continued to decline with the Dow Jones Industrial Average falling to 1132 by the end of the second quarter.

Third Quarter

Economic growth slowed in the third quarter largely because of the substantial rise in interest rates which had occurred during the previous two quarters. Long-term rates peaked at the end of the second quarter. Consumer expenditures were flat, housing expenditures declined but nonresidential investment continued to increase. The trade deficit grew larger as imports climbed faster than exports and business inventories rose. Consequently, annual growth in real GNP slowed to 1.6%.

Short-term interest rates rose through mid-August because the Federal Reserve continued a restrictive monetary policy. The Federal funds rate peaked at 11.8% in mid-August. Also, there were debt restructuring negotiations with several countries and financial strains in certain sectors of the U.S. economy such as agriculture and oil drilling. Federal assistance was also required for Financial Corporation of America. Bankers maintained higher reserves as a precaution against a liquidity crisis. Thereafter, monetary policy became more accommodating. By the end of the third quarter, the Federal funds rate declined to 10.7%.

The yield curve became flatter as long-term interest rates began declining at the beginning of the third quarter. This occurred despite the $52 billion of new debt issued by the Treasury. Foreign demand for U.S. government securities increased with the removal of the 30% withholding tax on foreign interest receipts from U.S. debt securities. At the end of the third quarter, the rate on 30-year government bonds fell to 12.3%. Stock prices rose in response to the mid-August easing of monetary policy and the Dow Jones Industrial Average ended the third quarter at 1207.

Fourth Quarter

Economic growth increased in the fourth quarter largely due to a significant reduction in the trade deficit. Consumer outlays rose as did government expenditures, but nonresidential investment eased while housing again declined. The rise in business inventories moderated. Inflation fell as prices rose less than 3%. Real GNP increased 4.3% in the fourth quarter.

Interest rates fell throughout the fourth quarter as the Federal Reserve continued a more accommodative policy because of concern over economic activity stalling, sluggish growth in M1 and a favorable inflation outlook. The discount rate was lowered to 8.5% in November and 8.0% in December. Rates dropped despite the Treasury issuing $60 billion of debt. By year-end, the Federal funds rate fell to less than 8.0% while the 30-year government bond rate was 11.5%. Nevertheless, stock prices did not appreciably rise as the Dow Jones Industrial Average ended the year at 1212.

Industry Profitability

Profitability plunged in 1984 because of rising interest rates and investors' fears over a clash between monetary and fiscal policies. The after-tax return-on-equity (ROE) in 1984 dropped to 7.2%, its lowest level since 1977 (Table 1). In comparison, the average after-tax ROE for all kinds of manufacturing was 12.8% in 1984. However, 1984 was even more disappointing for most firms then is indicated by the industry's ROE as a very high proportion of pre-tax income was earned by a relatively small number of firms. The ten firms categorized as Large Investment Banks (LIBs) received 72% of the industry's pre-tax income and enjoyed an after-tax ROE of 16.8%. Excluding the LIBs, the industry's after-tax ROE was a dismal 2.9%. Just as discouraging, 35% of all NYSE firms doing a public business were unprofitable in 1984.

Table 1

Securities Industry After-Tax ROE

Annual After-Tax ROE		Standard Deviation of Quarterly After-Tax ROE		1984 Quarterly After-Tax ROE	
1977	6.9%	1977	2.3	I	9%
1978	11.2	1978	12.6	II	(2)
1979	15.6	1979	2.4	III	12
1980	26.6	1980	9.0	IV	9
1981	19.4	1981	7.2		
1982	22.0	1982	14.6		
1983	19.8	1983	10.6		
1984	7.2	1984	6.2		

( ) Negative

Pre-tax income dropped 58% in 1984 from 1983. Revenue growth slowed to 6% while expenses rose 15%, largely because of higher interest expense. Indeed, the climb in interest expense accounted for 89% of the rise in costs. Proximate non-interest revenues decreased 4% while non-interest expenses increased 2%.[1] As a result, the industry's pre-tax profit margin dropped sharply (Table 2).[2] The ROE was also adversely affected by a decline in asset turnover, a rough "productivity" measure of assets. The leverage ratio, which measures the degree debt is relied upon to support the asset base compared to equity, rose to over 19%.

---

[1] Proximate non-interest revenues consist of total revenues less margin interest revenue and other-related revenue.

[2] Profit margin (pre-tax earnings per dollar of revenue) times asset turnover (revenues per dollar of average assets) times leverage (average assets per dollar of average equity) times the tax retention rate (1 minus industry tax rate) equals after-tax earnings per dollar of average equity (ROE).

Table 2

Component Analysis of Industry After-Tax Return on Equity

	Profit Margin	x	Asset Turnover	x	Leverage	x	Tax Retention Rate	= ROE
1982	.1308%		.1787		17.3%		54.0%	21.9%
1983	.1294		.1631		17.3		54.0	19.8
1984	.0515		.1348		19.1		54.0	7.2

On a quarterly basis, pre-tax profits ranged from a high of almost $700 million during the third-quarter of 1984 to a loss of $98 million in the second-quarter, the first quarterly loss since the fourth-quarter of 1978. Annualized after-tax ROE was comparatively low for each of the quarters. Also, the volatility of 1984 quarterly profits was the lowest since 1979 as is indicated by comparing the respective standard deviations (Table 1). In recent years, there has been a positive relationship between volatility in quarterly profits and ROE. In 1984, the volatility in quarterly profits and annual ROE were both relatively low.

Revenues

Total revenues rose from $29.5 billion in 1983 to $31.2 billion in 1984. Two important revenue sources, commissions and underwriting, both actually fell last year (Table 3). However, trading profits, margin interest and other related-revenues to the securities business increased.

Table 3

Securities Industry Revenues, 1983 and 1984

(millions of dollars)

REVENUES[1]	1983		1984	
	Dollars	% of Total	Dollars	% of Total
Commissions				
Listed Equities on an Exchange	$6,129.7	20.7%	$5,232.6	16.8%
Listed Equities Executed OTC	112.3	0.4	75.0	0.2
Listed Options	796.6	2.7	822.3	2.6
Other	1,304.1	4.4	964.7	3.1
Total	8,342.9	28.2	7,094.6	22.7
Trading Profits				
Market Making OTC	1,380.9	4.7	862.9	2.8
Debt Securities	4,417.8	15.0	5,524.9	17.7
Options on Nat'l Exchange	63.6	0.2	31.1	0.1
Other	981.3	3.3	1,147.7	3.7
Total	6,838.8	23.1	7,563.8	24.2
Investment Profits				
Realized	495.7	1.7	697.7	2.2
Unrealized	178.0	0.6	(10.4)	(0.0)
Total	742.9	2.5	713.8	2.3
Underwriting				
Equity Securities	754.2	2.6	248.3	0.8
Total	3,536.7	12.0	2,706.1	8.7
Margin Interest	2,125.5	7.2	2,867.8	9.2
Mutual Fund Sales	952.0	3.2	750.9	2.4
Account Supervision	569.6	1.9	693.8	2.2
Research	18.7	0.1	11.1	0.0
Commodities	826.1	2.8	739.3	2.4
Other-Related	4,384.1	14.8	6,282.8	20.1
Other-Unrelated	1,207.6	4.1	1,792.1	5.7
TOTAL REVENUES	$29,544.9	100.0%	$31,216.0	100.0%
TOTAL EXPENSES	$25,721.6		$29,608.2	
PRE-TAX NET INCOME	$3,823.3		$1,607.8	

( ) Negative

[1] Discrepancies may exist due to rounding.

Source: Securities Industry Database

Commissions

Commissions fell 15% in 1984, the most significant drop since 1974 when a similar decrease occurred (Table 4). In addition, commissions accounted for only 23% percent of total revenues, the lowest percentage recorded since such data were first tabulated by the regulatory organizations. For the first time, commissions were not the largest annual revenue source as they were overshadowed by trading profits.

Table 4

Commission Revenues

(millions of dollars)

Commissions	1983	1984	% Change
Listed Equities on Exchanges	$6,129.7	$5,232.6	(14.6)%
Listed Equities Executed OTC	112.3	75.0	(33.2)
Listed Options	796.6	822.3	3.2
Other	1,304.1	964.7	(26.0)
Total	$8,342.9	$7,094.6	(15.0)%

The amount of commissions received by the industry is based upon volume (activity) and the average commission per share of stock traded (price). Commission charges, in turn, are impacted by the mix of retail and institutional activity, changes in commission rates and the average price per share of stock traded. In 1984, total share volume on stock exchanges less member trading increased less than 2%; however, the average commission per share of stock traded dropped in 1984 which caused total commissions to fall (Table 5).[3]

---

[3] Total share volume including purchases and sales less member trading on the NYSE, AMEX and regional exchanges is estimated to have risen from 43.1 billion shares in 1983 to 43.8 billion shares in 1984, or by 1.6%. Firms generally obtain mark-ups from customer transactions in NASDAQ stocks rather than commissions. Consequently, these mark-ups are reported in trading profits and not in commissions.

Table 5

Equity Sales Volume, Price and Value[1]

1984

Registered Stock Exchanges	Average Daily Share Volume (In Millions)	Annual Share Volume (In Millions)	Price/Share Traded	Dollar Value of Shares Traded (In Millions)
NYSE	91.2	23,071	$33.15	$764,737
AMEX	6.1	1,545	13.82	21,349[2]
Regional Exchanges	14.1	3,571	33.70	120,359
	111.4	28,187	$32.16	$906,445

1983

Registered Stock Exchanges	Average Daily Share Volume (In Millions)	Annual Share Volume (In Millions)	Price/Share Traded	Dollar Value of Shares Traded (In Millions)
NYSE	85.3	21,590	$33.45	$765,275
AMEX	8.2	2,081	15.14	31,501[2]
Regional Exchanges	13.3	3,368	31.67	106,653
	106.9	27,039	$33.41	$903,429

---

[1] Round-lot data.

[2] AMEX dollar value of shares traded includes odd-lot.

Sources: NYSE, AMEX and NASDAQ Fact Book, 1983 and 1984.

The decline in retail activity was a major reason for the fall in the average commission per share of stock traded. The estimated proportion of total commissions from retail business dropped from 40% in 1983 to 35% in 1984 (Table 6), explaining a significant proportion of the drop in the average commission per share.[4] Moreover, institutional commission rates declined in 1984 due to intense competition.

Table 6

Estimated Percentage of Retail & Institutional Commissions, 1983-1984

	Estimated Retail Commissions		Estimated Institutional Commissions	
Quarter	1983	1984	1983	1984
I	45.2%	34.5%	54.8%	65.5%
II	43.1	34.4	56.9	65.6
III	37.5	33.8	62.5	66.2
IV	34.4	36.7	65.6	63.3
Year	40.0%	34.8%	60.0%	65.2%

---

[4] The most recent year for which the SEC conducted a survey to determine retail versus institutional commissions was in 1981 when retail commissions were 65% and institutional commissions were 35% of total commissions. The retail percentage of total commissions is estimated for later periods by using the following ratio:

$$\frac{.65}{X} : \frac{(1-[10{,}000 \text{ share blocks \& member trading as \% NYSE volume, 1981}])}{(1-[10{,}000 \text{ share blocks \& member trading as \% NYSE volume, period } X])}$$

The institutional percentage of total commissions is the residual.

For example, the ratio to estimate the percentage of retail commissions for 1983 is:

$$\frac{.65}{X} : \frac{(1-[.318 + .266])}{(1-[.456 + .288])} \quad \text{or} \quad \frac{.65}{X} : \frac{.416}{.256}$$

Trading Profits

Trading profits were one of the few major revenue sources to increase last year, rising to a record $7.5 billion from $6.8 billion reached in 1983, a 10.6% increase (Table 7). In addition, they were the largest revenue source on an annual basis for the first time ever. Nearly 60% of 1984's trading profits occurred in the third and fourth quarters when interest rates were declining.

Table 7

Trading Profits

(millions of dollars)

	1983	1984	% Change
OTC Market Making	$1,380.9	$ 862.9	(37.5)%
Debt Securities	4,417.8	5,524.9	25.1
Options on Nat'l Exch.	63.6	31.1	(51.1)
Other	981.3	1,147.7	17.0
	$6,838.8	$7,563.8	10.6%

( ) Negative

Among the components, trading profits on debt securities climbed 25% from 1983 and accounted for 73% of total trading profits. However, OTC market making plunged about 38% as OTC equity prices fell in the second and fourth quarters.

Underwriting

Underwriting revenues fell almost 24% in 1984, the sharpest decrease among the largest revenue sources (Table 8). Clearly, 1984 was a disappointing year for underwriting, but last year's performance suffers from a comparison with 1983. In 1983, underwriting revenues jumped 52% from 1982 to a record $3.5 billion. Thus, 1984 underwriting revenues, although down from 1983, were still 17% higher than in 1982 and significantly greater than in any other year except 1983. The 1984 drop in underwriting revenues occurred largely because of the 67% plunge in revenues from underwriting equity securities. Revenues from underwriting debt securities decreased by 12%.

Table 8

Underwriting Revenues

(millions of dollars)

	1983	1984	% change
Equity Securities	$754.2	$248.3	(67.1)%
Non-equity Securities	2,782.5	2,457.8	(11.7)
Total	$3,536.7	$2,706.1	(23.5)%

Corporate underwriting volume on a net proceeds basis fell to $82.2 billion in 1984 compared with the record $97.1 billion in 1983 (Table 9). However, debt financing rose to a record $69.3 billion from $52.2 billion. Common stock offerings plunged to $8.9 billion in 1984 after reaching a record $36.7 billion the previous year. Also, IPOs fell to $3.8 billion in 1984 compared with the record $12.4 billion in 1983.

Table 9

Underwriting Volume

(billions of dollars)

	1983		1984		% change	
	Dollars	No. of Issues	Dollars	No. of Issues	Dollars	No. of Issues
I. Corporate						
Bonds	$52.2	605	$69.3	648	32.8%	7.1%
Preferreds	8.3	131	3.9	70	(53.0)	(46.6)
Common	36.7	1,418	8.9	557	(75.7)	(60.7)
IPOs	12.4	686	3.8	351	(69.4)	(48.8)
	$97.1	2,154	$82.2	1,275	(15.3)%	(40.8)%
II. Municipal						
Rev. Bonds	$60.8	NA	$74.4	NA	22.4%	NA
GOs	22.6	NA	27.5	NA	21.7	NA
	$83.4	NA	$101.9	NA	22.2%	NA

( )Negative

NA Not Available

Sources: Dealers' Digest Inc. and The Bond Buyer

Negotiated Rule 415 total offerings on a net proceeds basis rose 10%, from $36.0 billion in 1983 to $39.7 billion in 1984. Rule 415 debt offerings climbed 42%, from $27.1 billion in 1983 to $38.5 million in 1984.[5] Such offerings represented 52% of corporate debt offerings in 1983 and nearly 56% in 1984. However, Rule 415 equity offerings plunged 86%, from $8.9 billion in 1983 to $1.2 billion in 1984.[6] As a percentage of total equity offerings, 415 offerings accounted for 20% in 1983 but less than 10% in 1984.

Municipal volume set a record of $101.9 billion in 1984, 22% greater than in 1983. In 1984, revenue bonds accounted for 73% of total municipal volume. Activity was limited in the first-half of 1984 because single-family mortgage revenue bonds could not be issued since they were sunsetted as of December 31, 1983. Moreover, there was uncertainty regarding the amount of industrial development bonds (IDBs) which could be sold. After enactment of the Deficit Reduction Act of 1984 in mid-year, volume climbed dramatically. The Act again permitted the sale of single-family mortgage revenue bonds and stipulated the annual limit on IDBs beginning January 1, 1985. Activity in IDBs soared during the fourth-quarter of 1984 prior to the effective date of the ceiling. Overall, more than 64% of 1984 volume was accounted for during the second-half of the year.

Concentration in underwriting revenues increased in 1984 for the Top 10 and particularly the Top 11-25 firms (Table 10). This occurred largely because of the drop in equity offerings, particularly IPOs, where smaller firms play a larger role in underwriting and distributing securities. In addition, the climb in Rule 415 shelf offerings increased concentration because such transactions are generally handled by larger capitalized firms.

Table 10

Concentration in Underwriting Revenues

Firm Rankings[1]	1980	1981	1982	1983	1984
Top 10	53.1%	50.4%	57.8%	46.2%	47.8%
Top 11-25	22.6	23.3	22.8	29.9	33.9
Top 25	75.6	73.7	80.5	76.1	81.7
Rest of Industry	24.3	26.3	19.5	24.0	18.3
	100.0%	100.0%	100.0%	100.0%	100.0%

---

[1] Firm rankings are by capital.

---

[5] Dealers' Digest Inc.

[6] *Ibid*.

The Top 11-25 firms' increased concentration in underwriting revenues in 1984 is somewhat surprising considering that two of the largest firms in this group were acquired during the year by Top 10 firms.[7] Also unexpected was the relatively small rise in concentration for the Top 10 firms. However, these changes seem to have occurred because of differences in the types of underwriting activities in 1984 compared with 1983. The Top 10 firms' comparatively small increase in concentration in 1984 appears to have resulted because of lower profit margins due to the increased importance of debt underwriting as well as larger deals. Profit margins on debt underwritings are smaller compared with equity underwritings and are lower, on average, as the size of the underwriting increases. The Top 11-25 firms' increase in concentration is explained by their role in the municipal business which rose significantly last year.

Margin Interest

Margin interest revenue climbed 35% in 1984 after increasing 6% in 1983. However, net margin interest income, not gross margin interest revenue, is the important variable for profitability. The trend in net margin interest is suggested by available data including NYSE customer margin debit balances, free credit balances, the broker call rate and the estimated rate charged margin customers (Table 11). Other data not available but useful in determining the profitability of margin business are cash debits against which free credits are used and revenues received by firms on stocks loaned on customer margin accounts. Available data indicate that net margin interest revenue rose in 1984 as customer margin debit balances climbed 27% and free credit balances increased 4%.

Table 11

Indicators of Net Margin Interest Income[1]

(billions of dollars)

	NYSE Customer Margin Debit Balances	Free Credit Balances	Average Broker Call Rate	Estimated Rate Charged Margin Customer
1981	$14.2	$ 9.0	17.85%	19.35%
1982	12.0	11.7	13.43	14.90
1983	17.8	14.4	10.09	11.44
1984	22.6	15.0	11.23	12.72

[1] All data are averages.

Sources: NYSE, Data Resources, Inc. and Lipper Analytical

---

[7] In 1984, Merrill Lynch acquired portions of A.G. Becker Paribas and Shearson/American Express acquired Lehman Brothers.

Other-Related

Other-related revenues to the securities business basically include interest on repos, M&A fees, private placement fees and interest earned on investments. In 1984, other-related revenues climbed 43% after increasing 12% in 1983. Interest on repos is believed to be the largest component of this revenue item. The overnight average repo rate increased from 9.1% to 10.1%, while the average amount of reverse repos climbed 52%, from $57.1 billion in 1983 to $86.9 billion in 1984.

M&A fees and private placement fees also contributed to the climb in other-related revenues. As reported by W.T. Grimm, M&A activity jumped to a record $122.2 billion in 1984, up from $73.1 billion in 1983. The previous high was $82.6 billion set in 1981. Factors contributing to this new peak in M&A activity were companies perceived as undervalued, structural changes in industries such as oil, computer software and broadcasting, as well as strategic takeovers.

A new record also occurred in private placements which rose in 1984 to $53.1 billion and included 1,781 issues compared with $35.6 billion and 1,597 issues in 1983. The private placement market is one of the fastest growing parts of the securities business. Annual volume last year was 119% greater than in 1982 and the growth in collateralized mortgage obligations (CMOs) has been the major contributing factor.

Growth in total revenues in 1984 was the smallest since 1977. Also, the trends which have existed since at least 1973--the growing importance of principal business and the diminishing importance of agency business--continued last year. Senior securities industry executives surveyed in the SIA/Arthur Andersen Delphi Study predicted that the trend of rising importance for trading and investment profits and the reduced importance of commissions would continue in the late 1980s.[8]

---

[8] SIA and Arthur Andersen & Co., Keys to a Changing Securities World, 1985, p.30-32

EXPENSES

As industry profits fell and many firms experienced losses, policies were adopted in 1984 to constrain overall costs although spending continued where prior commitments had to be met and in areas necessary to remain competitive. Total expenses climbed 15% compared with revenues increasing only 6% (Table 12). However, non-interest expenses rose only 2% while proximate non-interest revenues decreased 4%.

Table 12

Securities Industry Expenses

(millions of dollars)

	1983		1984	
EXPENSES[1]	Dollars	% of Total Revenues	Dollars	% of Total Revenues
Registered Rep. Comp.	$5,748.3	19.5%	$5,248.5	16.8%
Clerical & Admin.	4,887.6	16.5	5,147.5	16.5
Partners' & Stock.	983.1	3.3	934.1	3.0
Other Employee Comp.	448.5	1.5	396.7	1.3
Floor Brokerage & Clearance	1,142.2	3.9	1,162.6	3.7
Fl. Brok.-Brokers	389.9	1.3	399.1	1.3
Comm. & Clear.-Others	390.2	1.3	395.3	1.3
Clear. Pd. Non-Brokers	246.4	0.8	257.9	0.8
Comm. Pd.-Other Brokers	115.8	0.4	110.7	0.4
Communications	1,536.7	5.2	1,766.4	5.7
Occupancy & Equipment	1,137.1	3.8	1,503.7	4.8
Promotional Costs	734.4	2.5	769.2	2.5
Interest	6,050.6	20.5	9,505.4	30.5
Error Accts. & Bad Debts	232.6	0.8	212.0	0.7
EDP Equipment Costs	342.2	1.2	419.8	1.3
Non-recurring Charges	98.5	0.3	26.2	0.1
Regulatory Fees & Exp.	133.7	0.5	144.9	0.5
Other	2,249.0	7.6	2,372.3	7.6
TOTAL EXPENSES	$25,721.6	87.1%	$29,608.2	94.8%

---

[1] Discrepancies may exist due to rounding.

Source: Securities Industry Database

Employment was the most significant expense item accounting for 36% of total expenses.[9] In 1984, total employee costs declined 3% which helped to limit the rise in total expenses (Table 13). This occurred because management exercised controls to limit both employment and salary increases while compensation tied to RR production fell due to the drop in such activity. Employment peaked in the first-quarter of 1984 as average employment last year rose moderately compared with 1983 (Table 14).[10] Reductions were made in clerical-administrative and other support personnel in the second and third quarters but registered representatives and other income producing personnel continued to rise throughout the year.

---

[9] Partners' and stockholders' employment costs are excluded from employment expenses.

---

[10] The following methodology was used to estimate the variables responsible for the change in employment expense by type of employee: (1) number of employees and (2) average compensation.

A. For RRs

RN_3 = average number of RRs in 1983
RN_4 = average number of RRs in 1984

RC_3 = average compensation per RR in 1983
RC_4 = average compensation per RR in 1984

$\triangle EE_4$ = change in employment expense in 1984

$\frac{(RN4 - RN3)(RC3)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 number of RRs

$\frac{(RC4 - RC3)(RN4)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 RR compensation

B. All Other + Non-RR Income Producing (AO + Non-RR)

ON_3 = average number of AO + Non-RRs in 1983
ON_4 = average number of AO + Non-RRs in 1984

OC_3 = average compensation per AO + Non-RR in 1983
OC_4 = average compensation per AO + Non-RR in 1984

$\frac{(ON4 - ON3)(OC3)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 number of AO + Non-RRs

$\frac{(OC4 - OC3)(ON4)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 AO + Non-RR compensation

Overall, higher 1984 average employment resulted in employment expenses increasing 8%. Compensation decreased in 1984 largely because of the 16% drop in the average compensation of RRs. Also, average compensation to all other employees declined 3.5%. Overall, the drop in compensation reduced employment expenses nearly 11%.

Table 13

Changes in Security Industry Expenses, 1983-1984[1]

	(million of dollars) Dollars	Percent
Employment		
Registered Rep. Comp.	$(499.8)	(8.7)%
Clerical & Admin.	259.9	5.3
Other	(51.8)	(11.5)
	($291.7)	(2.6)%
Fixed Expenses		
Communications	$229.7	14.9%
Occup. & Equip.	366.6	32.2
EDP	77.6	22.7
	$673.9	22.3%
Interest	$3,454.8	57.1%
Floor Brok. & Clear.	20.4	1.8
Promotional Costs	34.8	4.7
Error Accts & Bad Debts	(20.6)	(8.9)
Partners' & Stock	(49.0)	(5.0)
Non-recurring Charges	(72.3)	(73.4)
Regulatory Fees & Exp.	11.2	8.4
Other	123.3	5.5
Total Expenses	$3,886.6	15.1%
Non-Interest Expenses	$431.8	2.2%

( ) Negative

[1] Discrepancies may exist due to rounding.

Source: Securities Industry Database

Table 14

Securities Industry Employee Expense

				% Change	
	1982	1983	1984	1982-1983	1983-1984
Average Number of Employees					
Reg. Reps.	57,120	64,925	70,640[2]	13.7%	8.8%
All Other[1]	113,845	127,045	136,835	11.6	7.7
	170,965	191,970	207,475	12.2%	8.1%
Average Compensation Per Employee					
Reg. Reps.	$71,865	$88,540	$74,300[2]	23.2%	(16.1)%
All Other[1]	36,640	42,000	40,520	14.6	(3.5)
	$47,125	$57,740	$52,020	22.5%	(9.9)%

( ) Negative

[1] Includes clerical, administrative, other support and some income producing employees.

[2] Estimated by SIA.

Sources: Securities Industry Database and NYSE Fact Book, 1984.

Fixed expenses climbed 22% and were largely responsible for the rise in non-interest expenses. Excluding fixed expenses, non-interest expenses would have declined 3%. Occupancy and equipment contributed most to the increase followed by communications and EDP equipment costs.

Most other expense items experienced either modest increases or decreases. For example, promotional costs rose 5% and "other" increased by less than 6%. Partners' and stockholders' employment costs declined 5% while bad debts fell 9%.

In the Delphi Study, securities firm CEOs ranked control of costs as the most important factor contributing to profitability in the securities industry during the rest of this decade.[11] In 1984, with industry profitability falling to its lowest level since 1977 and numerous firms experiencing losses, the industry had to become more serious about controlling costs.

---

[11] SIA and Arthur Andersen & Co., Keys to a Changing Securities World, 1985, p.41.

CONCENTRATION

Concentration, as measured by total revenues, increased in 1984 resuming the upward trend which had existed since at least 1979 and which was broken only in 1983 when favorable market conditions attracted additional firms into the industry (Table 15). The drop in industry profitability in 1984 caused a reduction in the number of NYSE firms from 405 in the fourth-quarter of 1983 to 396 in the fourth-quarter of 1984. Also, Lehman Brothers and A.G. Becker Paribas, two firms in the Top 11-25 in 1983, were acquired by two firms in the Top 10. As a result, concentration in capital rose among the Top 10 firms. The larger firms are continuing their diversification and expansion away from the securities business. It's interesting to see the different trends in concentration in commissions and total revenues.

Table 15

Securities Industry Concentration, 1979-1984

	1979	1980	1981	1982	1983	1984
Total Revenues						
Top 10	48.7%	53.1%	55.6%	57.3%	54.4%	58.8%
Top 11-25	18.6	19.4	18.7	18.7	19.6	17.1
Rest of Industry	32.7	27.5	25.8	23.9	26.0	24.1
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Commissions						
Top 10	40.0%	43.6%	43.4%	42.8%	42.0%	42.1%
Top 11-25	20.0	21.1	20.8	20.9	20.8	19.1
Rest of Industry	40.0	35.1	35.8	36.4	37.2	38.8
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Capital						
Top 10	45.8%	50.8%	50.0%	54.8%	52.8%	57.2%
Top 11-25	18.8	18.00	19.7	18.3	18.8	15.6
Rest of Industry	35.4	31.1	30.3	26.9	28.3	27.2
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

---

[1] Firm rankings are by capital.

Source: Securities Industry Database

Ira Epstein
Assistant Director
of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	March 1985	YEAR-TO-DATE 1985	March 1984	YEAR-TO-DATE 1984	% CHG. Y-T-D 1985 - 1984
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	102.6	113.2	84.3	95.5	18.5%
AMEX (MILS.)*	8.7	9.4	5.4	6.3	49.2
NASDAQ (MILS.)*	76.7	83.1	57.8	61.3	35.6
REGIONAL EXCHANGE (MILS.)*	20.2	19.6	12.4	14.1	39.0
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	76,916	242,187	63,905	209,003	15.9
AMEX (MILS.)	2,465	7,025	1,646	5,579	25.9
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,618	20,375	7,242	22,390	9.0
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,404	49,510	13,729	41,375	19.7
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.9	51.0	49.6	49.3	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	12,060	37,236	9,515	29,075	28.1
AMEX OPTIONS	2,914	9,131	3,591	9,973	(8.4)
COMMODITY	13,602	39,667	13,959	37,597	5.5

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	March 1985	March 1984	Basis Point Chg. Mar. 85 - Mar. 84
BOND BUYER INDEX (20 BOND)	9.77	9.97	(20)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.56	12.57	(1)
Baa CORPORATE	13.69	13.99	(30)
RATIO Aaa CORPS. TO Baa CORPS.	0.92	0.90	----
MUNICIPAL BOND YIELDS (MOODY'S)	9.77	9.41	36

PRICES

(END OF MONTH)

	March 1985	March 1984	% Change Mar. 85 - Mar. 84
DOW JONES INDUSTRIALS	1266.78	1164.89	8.7
STANDARD & POOR'S 500	180.66	159.18	13.5
NYSE COMPOSITE	104.60	91.67	14.1
AMEX MARKET VALUE INDEX	229.59	211.30	8.7
VALUE LINE COMPOSITE	194.53	182.19	6.8
NASDAQ COMPOSITE	279.20	250.78	11.3

UNDERWRITING
(DOLLARS IN MILLIONS)

	FIRST QUARTER 1985	FIRST QUARTER 1984	% CHANGE 1985 - 1984
CORPORATE FINANCING (Gross New Issues)			
Total	21,017	17,909	17.4%
Common Stock	4,237	2,271	86.6
# of Common Stock Issues	126	167	(24.6)
Preferred Stock	1,045	1,114	(6.2)
# of Preferred Stock Issues	15	19	(21.1)
Corporate Debt	15,734	14,524	8.3
# of Corporate Debt Issues	227	183	24.0
MUNICIPAL FINANCING (Gross New Issues)			
Total	22,707	22,731	(0.1)%
Notes	1,802	8,138	(77.9)
Bonds	20,905	14,593	43.3

MARGIN DEBT

	March 1985	March 1984	% Change Mar. 85 - Mar. 84
MARGIN DEBT OUTSTANDING ($MILS)	23,320	22,460	3.8 %
NET CHANGE IN MARGIN DEBT ($MILS)	860	8,290	89.6
% OF ACCOUNTS WITH EQUITY UNDER 40%	11	11	-------

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1984	Yr.-To-Date 1984	Fourth Quarter 1983	Yr.-To-Date 1983	% Change 4th Q. 1934 4th Q. 1983	Yr.-To-Date % Change 1984 - 1983
REVENUE						
SECURITIES COMMISSION INCOME	$1,708	$7,095	$1,877	$8,326	(9.0)%	(14.8)%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,577	8,278	1,659	7,571	55.3	9.3
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	871	2,706	812	3,537	7.3	(23.5)
TOTAL REVENUE	8,518	31,216	7,245	29,515	17.6	5.8
TOTAL EXPENSES	8,015	29,608	6,928	25,706	15.7	15.2
NET INCOME BEFORE TAXES	503	1,608	317	3,809	58.7	(57.8)
PERCENT OF FIRMS SHOWING LOSS	36.2%	36.5%	37.3%	14.5%	---	---

ITEM	DESCRIPTION	SOURCE
"1985 First Quarter Corporate Finance Roundup"	Statistical review of underwriting activity, including ranking of managers and co-managers overall and in various securities plus listings of the largest deals.	Investment Dealers' Digest 4/9/85
Flatter Taxes & Fatter Bases	Four-part booklet evaluating 3 leading modified flat income tax plans--Treasury, Bradley-Gephardt, and Kemp-Kasten, with emphasis on Treasury proposal. Criteria for evaluation are simplification objectives and economic impact. Simplification is considered in terms of both ease of compliance and for tax/investment planning.	Tax Foundation, Inc. One Thomas Circle, N.W. Washington, D.C. 20005 $10 per copy
IRAs--The People's Choice	Report discusses: 1. growth of IRAs, 2. structure of market, 3. characteristics and attitudes of IRA owners and non-owners, and 4. impact of IRAs on savings. Data derived in part from recent survey of households.	Investment Company Institute 1600 M Street, N.W. Washington, D.C. 20036
"How to Manage Investor Relations"	According to author Charles Ellis, the professional, institutional investor is, and has been, the dominant force in securities markets. The most effective -- and least costly -- strategy for investor relations management should be aimed at institutional investors and based on the concepts of industrial marketing. This strategy will also meet the objectives of an individual investor program because the extensive information organized for institutional investors also serves the needs of individuals.	Financial Analysts Journal March/April 1985
"Up the Revolution--Change Sweeps Over London Exchange"	A look at current activity in London as stock brokerage firms prepare for the end of fixed commissions, scheduled for late 1986. Expected changes have set off regroupings, with almost every major brokerage firm linking up with capital-rich partners. Driving force behind link-ups reportedly British, American and Swiss Banks.	Barron's 4/22/85

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Keys to a Changing Securities World	SIA/Arthur Andersen Delphi study of the securities industry in the late 1980s, on which the presentations at the SIA Spring Meeting were based.	Communication Services Arthur Andersen & Co. 69 West Washington St. Chicago, Illinois 60602 $50 SIA members; $75 others
Interim Report on Sales Compensation Practices in the Securities Industry	Based on survey of compensation plans in effect in latter part of 1984 and payouts, ticket sizes, etc. in 1983. Report presents demographic statistics on 39 participating firms, summary highlighting major features of industry compensation plans, complete sales compensation plans in effect in 1981 and 1984 at participating firms, and changes in those plans recently implemented or anticipated.	SIA Publications Dept. $275 SIA members; $550 others
"Tax Reform" Four-part Editorial Series	Common sense observations on the tax reform debate. Key to writing tax reform bill targeted at economic growth is overcoming constraints of Treasury's static revenue neutrality. There is more to gain by reducing incentives for tax avoidance and uneconomic allocation than there is to lose through lower marginal rates. Revenues were generated by the 1978 capital gains tax cut and, despite the 1981 rate reductions, those with incomes of $100,000+ paid higher taxes in 1982 and 1983.	Wall Street Journal April 3--15

Securities Industry Trends

ANNUAL SUBSCRIPTION
$36.00 member • $60.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1

Vol. XI, No. 3 May 13, 1985

THE DELPHI STUDY - KEY FINDINGS AND IMPLICATIONS FOR FIRMS

This issue of Securities Industry Trends reviews the presentation on the "Delphi Study - Key Findings and Implications" made at the 1985 SIA Spring Management Conference. The main purpose of the presentation was to provide firms in the securities industry with analyses to assist in future planning decisions.

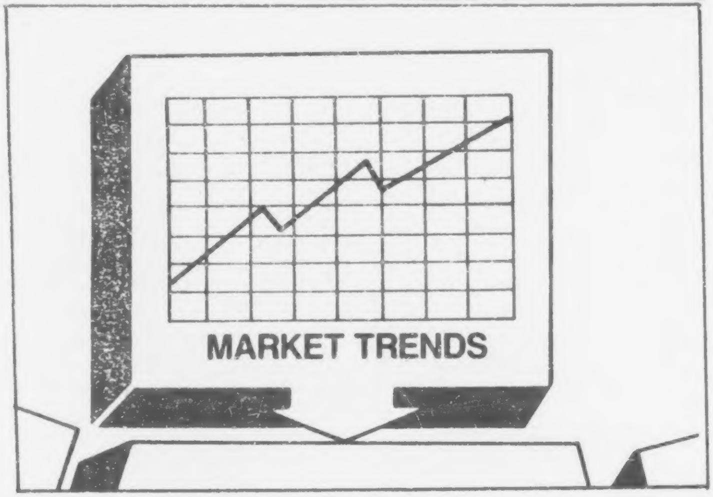
In the Spring of 1984, SIA and Arthur Andersen & Co. undertook a joint Delphi Study of future trends in the securities industry, entitled Keys to a Changing Securities World. The study took nine months to complete, and the results indicate the collective thinking of over 600 individuals involved in the securities business. These individuals, whose very actions can influence the future, were divided into panel groups. The panels consisted of: CEOs of securities firms, senior management at firms, CEOs of competitor organizations, regulators and legislators, and industry observers such as academics, lawyers and analysts. In addition, institutional, retail and corporate customers were surveyed.

The Delphi Study describes how participants believe the securities industry will evolve during the late 1980s. Panelists predicted how key forces of change would alter industry structure and how firms, in turn, would respond to these changes, thus precipitating even more change.

We will discuss several of the key findings of the study and their possible implications for securities firms. However, the real practical value of the Delphi study would be for each firm to examine the key findings on competition, products, costs, etc., and to determine whether or not they agree with the assumptions and findings. From this exercise, firms will derive their own picture of the securities business as it may exist in the late 1980s and will be in a position to say: Here's our best perception...what do we do about it?

This paper is designed to help advance the process of using the SIA/AA study as a basis for discussing planning and strategy within individual firms. The Study is a guide, not a blueprint.

It is necessary to first set the stage. How did our Delphi participants view the operating environment in the late 1980s? (Chart 1)



Not surprisingly, panelists projected greater share volume. NYSE average daily share volume is projected at 135 million shares in 1988, compared to 85 million shares in 1983 and 91 million shares in 1984. As of the end of March, average daily share volume in 1985 was 108 million, up 18.5% from last year.

NASDAQ average daily share volume was predicted at 102 million shares in 1988, compared to 63 million shares in 1983 and a slight drop to 60 million shares last year. Through the first three months of 1985, average daily share volume has been 82 million, up 36% from 1984.

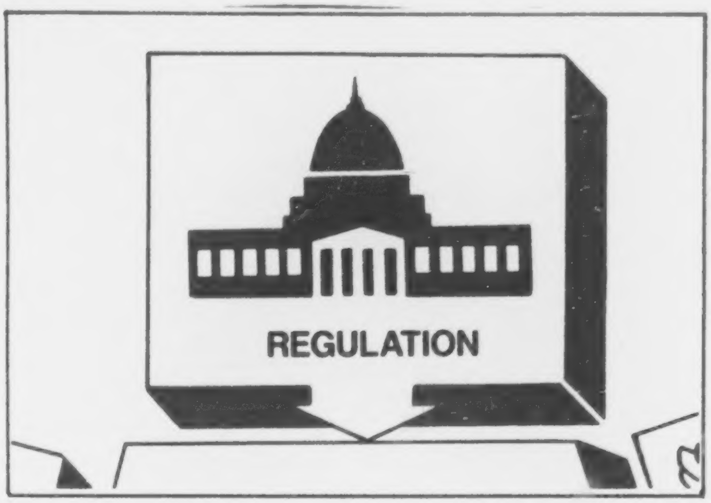
In effect, panelists project a slowdown in the annual rate of growth in volume to 10% during the 1984-88 period for both the NYSE and NASDAQ. This compares with growth rates of 25% and 42% for those markets, respectively, from 1978-83. Even though activity was up sharply during the first quarter of 1985, the increase trails those from 1978 through 1983.

To predict volume is almost as perilous as predicting stock prices or interest rates. Nobody is able to predict what levels of activity will be for the rest of this year or over the next few years, but firms may want to consider the implications of a slowdown in expansion relative to the period of 1978-1983. What does this mean for various expenses, including the hiring of sales persons and other personnel?

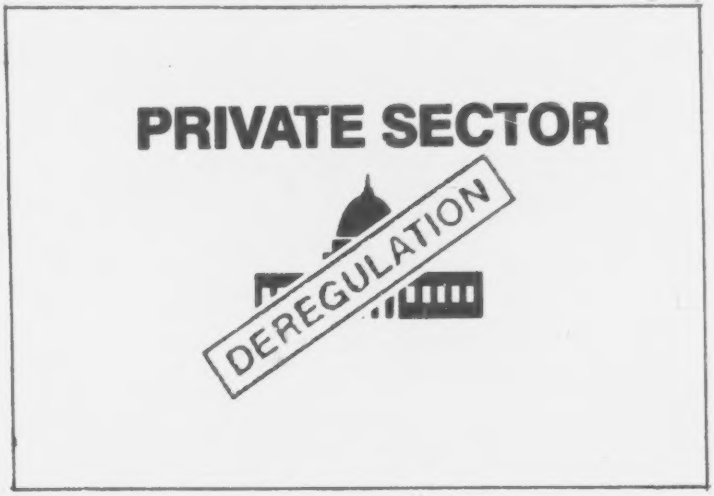
The strong dollar in 1984 and the record amounts of foreign capital inflows make internationalization of markets a very relevant topic. Since the late 1960s, foreigners have played a major role in the U.S. equity market. We estimate they account for about 10% of public volume on the NYSE and their net purchases probably comprise 20%-25% of net additional stock issued each year. However, with the depressed stock market last year, foreigners were net sellers of U.S. equities while purchasing massive amounts of U.S. fixed income instruments. On the other side of the ledger, more and more individuals expect U.S. money managers to invest in foreign companies as a way of diversifying and seeking out new opportunities. Clearly, the relative strength of the dollar has much to say about this trend.

Delphi panelists expect internationalization of markets to increase, with the pace faster in debt instruments. Much has been made and said about 24-hour trading markets. However, no one has been very specific about what increased internationalization means for firms. Internationalization has already progressed substantially in debt instruments with the rapid growth of the Eurobond market. Individuals from one country are buying obligations of issuers of other countries. In the international trading of equities, this is likely to proceed at a slower rate because equities lend themselves less to commodity-type transactions as compared to debt instruments. Firms will most likely want to consider what internationalization means in terms of their bottom line. Moreover, some regulatory issues are raised by internationalization.

No topic concerning the financial services industry has received more attention than regulation. What were the participants' views on future regulation? (Chart 2)



Participants from the private sector believe there will be further deregulation for all sectors of the financial services industry. (Chart 3) Panelists from the public sector, i.e., regulators and legislators, do not agree that future change will necessarily be deregulatory in nature. (Chart 4) What is the end result? We may see increased regulation in certain areas, and less regulation in others. Also, regulation is here to stay and meeting its demands will continue to have a major impact on management practices and costs.



PUBLIC SECTOR

The Delphi Study implies that there will be a protracted struggle between the private and public sectors over future regulatory changes. Given recent events in the government market, we can expect more rather than less regulation in this area. Practically speaking, time spent in reviewing possible trends should allow firms (1) to identify possible areas of regulatory change, (2) put an assessment of likelihood and timing on each, (3) decide what each change would mean to the firm and (4) what, if anything, to do about it. In other words, time to get ready. The securities industry and other financial service sectors may become increasingly frustrated with the slowdown in the trend toward further deregulation, in light of possible additional regulation in certain key sectors. For example, the recent problems of Bevill Bresler & Schulman and ESM give rise to the likelihood of increased regulation in the government securities market.

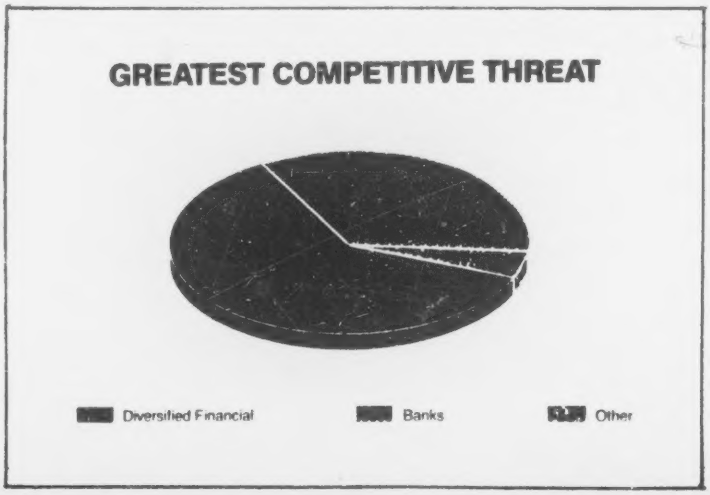
Deregulation, or reregulation as some will call it, can affect any of a wide range of areas. Will there be removal or easing of the McFadden Act's restrictions on interstate banking? What about easing of margin regulations, changes in non-bank bank opportunities, or the ability of banks and brokers to enter each other's businesses. Future deregulation will, in some cases, pave the way for future competition. The likelihood is that pressure for these developments to take place will continue unabated and that future planners for our industry should be very conscious of the potential for change in these areas.

Participants put a great deal of emphasis on greater competition from non-traditional competitors, (Chart 5)

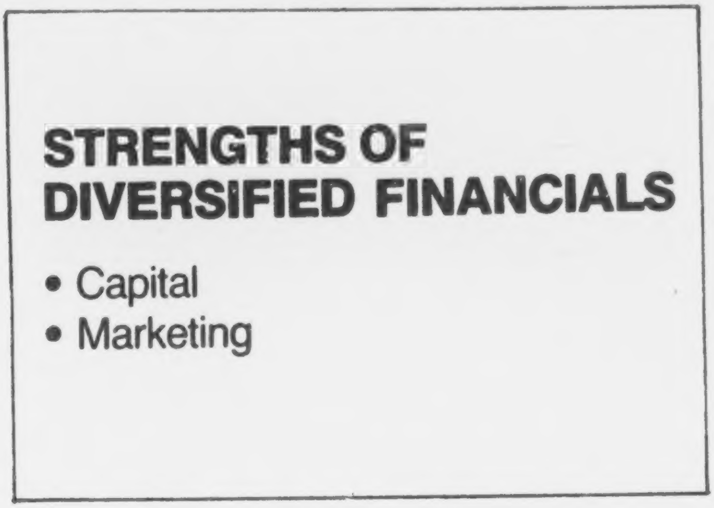
EXTERNAL COMPETITORS

banks, insurance companies, retailers and international organizations. Management's first challenge will be to accurately size up the competitor's strengths and weaknesses, as well as the programs and products actually being offered. Market research into these competitors' practices is a must. Where are competitors the most vulnerable? What do competitors offer customers that securities firms don't? What tactics should a firm take to prevent the erosion of its customer base? Competition may force some firms to continue to offer new products despite a general recognition that many of these products are not needed or wanted by most customers and add to overhead costs.

According to the Delphi study, the greatest competitive threat will come from the diversified financial service company, followed by banks. (Chart 6)



The strengths of the diversified financial firms lies in large capital bases and more consumer oriented marketing abilities. (Chart 7)



STRENGTHS OF DIVERSIFIED FINANCIALS

- Capital
- Marketing

Firms feel a greater need to attract additional capital. Ownership equity by year-end 1984 was over $12.7 billion, with total capital exceeding $16 billion. However, as a percentage of total assets, ownership equity was only 4.6%, down from 5.5% at year-end 1983. The industry's use of leverage was at a ten year high at year-end 1984. The trend toward principal activities and away from agency business has clearly intensified capital needs of securities firms.

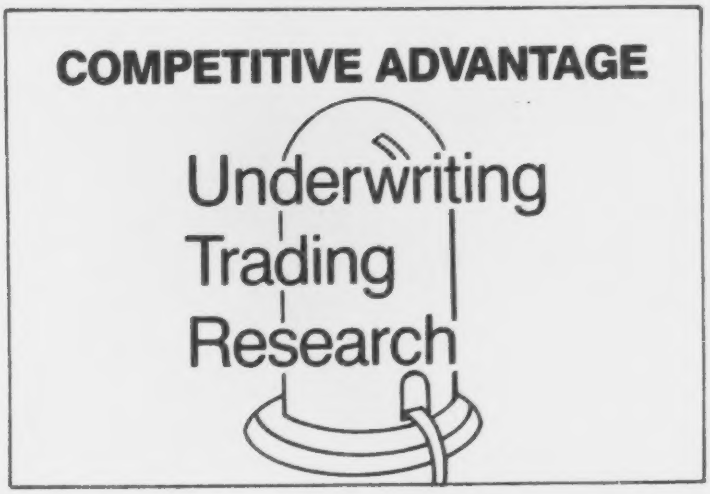
If the strength of the diversified financial firms lies in capital and marketing, firms will want to identify which areas diversified financials will be powerful competitors in? Trading? Investment banking? Technology? Training? Mass merchandising? By identifying areas such as these, firms can begin to decide where they want to compete and, in those cases, how they can compete given what may be vast differences in resources.

Not all firms will want to compete in every area. Some firms will clearly decide that they do not want to offer a multitude of products to all customers. Firms have been starting to question the range of products and services they now offer. In the future, they may be more interested in determining whether a particular product or service is profitable rather than simply whether another competitor offers a similar product or service. Many firms are now not only questioning the range of products and services they recently created, but the fixed overhead that comes along with many of these innovations. Choosing which businesses to eliminate or reduce may be a more important managerial decision than deciding which new business to enter or existing business to expand in. Moreover, what will become of critical importance will be the ability of firms to understand target markets, because in many cases firms as well as competitors will be going after the same markets.

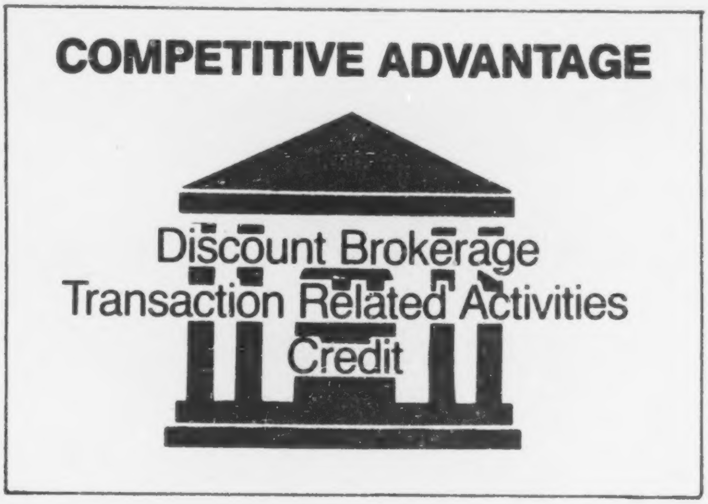
As we are beginning to see, being a financial supermarket does not necessarily guarantee success. Delphi participants felt that a financial supermarket may not succeed because of: (1) lack of management expertise in all business lines, (2) customer nonacceptance, and (3) an inability to retain key staff.

Firms are well aware of the problems of retaining key personnel when mergers take place. Often, many of the key personnel, for various reasons, choose to leave the merged entity to go elsewhere. An intimate knowledge of the industry and a specific corporate culture developed by the needs of a very dynamic business will still be major competitive advantages for smaller securities firms.

In the future, panelists project that the securities industry will retain competitive advantages in underwriting, trading and research. (Chart 8) Banks will

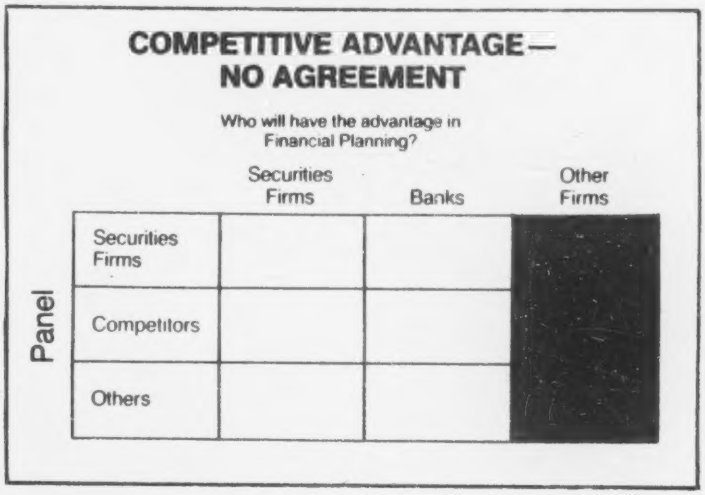


have a competitive advantage in discount brokerage, transaction-oriented activities, and credit products. (Chart 9) Neither the securities industry nor banks will have an edge in offering financial planning services. Given the fact that many securities firms and deposit taking institutions are engaged in plans to combine teams of individual specialists to provide comprehensive financial planning to their customers, the lack of enthusiasm indicated in responses by customers should be weighed carefully. (Chart 10) There still remains a lot of work to do in convincing customers that securities firms or banks or any one institution should handle all of their financial planning.



COMPETITIVE ADVANTAGE

Discount Brokerage
Transaction Related Activities
Credit



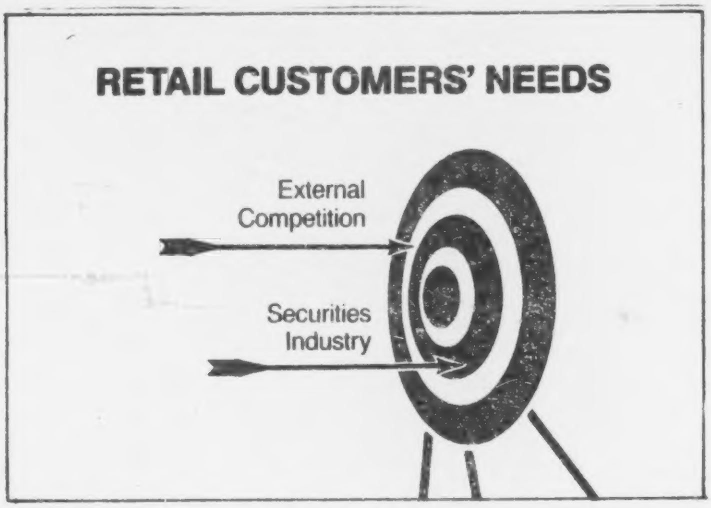
COMPETITIVE ADVANTAGE— NO AGREEMENT

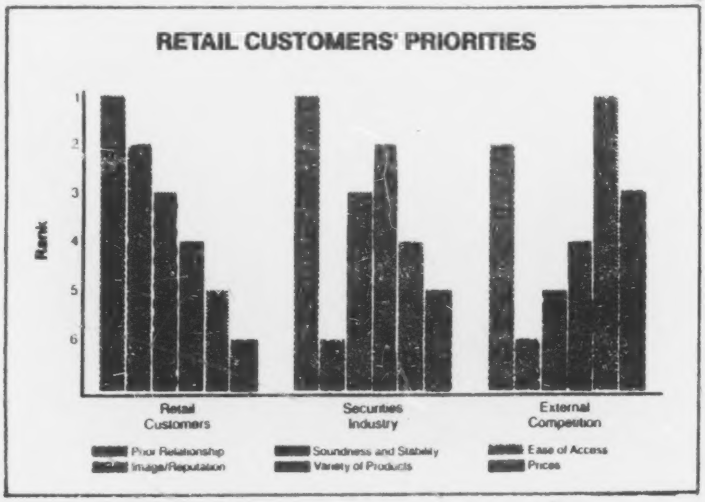
Who will have the advantage in Financial Planning?

Panel	Securities Firms	Banks	Other Firms
Securities Firms			▨
Competitors			▨
Others			▨

What does the retail customer really want and need? How did the securities firms compare with competitors in evaluating the needs of the retail customer?

Although customer preferences were ranked in the top three factors affecting the securities business, the Delphi survey showed that neither the securities industry nor its competitors fully understand the needs of the retail customers. (Chart 11) Among the differences were the following: Firm image is very important to the retail customer, but this value was ranked lowest by the providers of financial services. (Chart 12) Customers ranked soundness and stability as the third most important value, while competitors ranked it low. The securities industry ranked variety of products and services the second most important variable; however, this value was no better than a fourth consideration for the retail consumer.





It is helpful to focus a moment on one of the most important values to our customers -- firm image. Financial service providers have not taken into account the customer perspective of the abstract term "image". Providers may be defining image in too narrow a sense, while "users" or our customers may define it as embracing reliability, integrity, competence -- and other factors that are understandably important to people in matters concerning money. If that's so, then there could be a powerful competitive advantage in seeking to project an image that conveys those attributes to customers.

Clearly, the difference between what customers want and what financial intermediaries think they want argues for increased market research at firms. Good readings on customer preferences will become critical as the industry and its competitors compete head-on for retail customers. There are signs that the sales orientation of many firms has already begun to change, as marketing research has gotten increased attention in recent years.

Marketing and product development was, in fact, picked by Delphi panelists as the number one choice for gaining an edge over competitors. Other choices given were strategic planning, entrepreneurial talent, productivity and technology. However, although some firms have added marketing expertise in recent years, an SIA survey shows that not more than maybe 30 firms have a fairly senior person devoting full time to marketing management.

Input from the sales force can be a powerful marketing tool. And it has been! RRs are the industry's traditional pipeline to the customer. Competitors, on the other hand, do not have salesmen as close to customers as our industry does. Hence, using RRs for input is a valuable edge. But few firms have capitalized on the opportunity to use this input in a systematic way. There may be many opportunities yet to be explored in the area of RR feedback.

It will be important in the future to augment RR input periodically with market and customer research. This would require the establishment of methods to directly survey customer needs and desires. One of the major challenges to firms will be to implement direct customer marketing without alienating the salesforce.

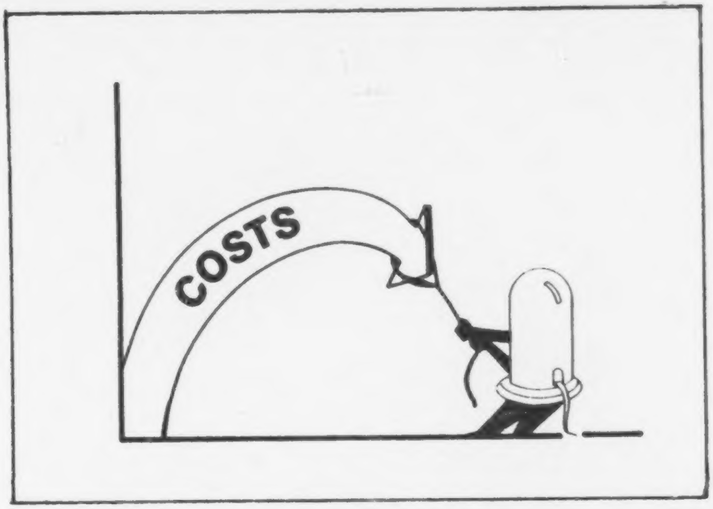
Indeed, much has been written about the changing role of the RR. According to the Delphi study, many securities firm executives and competitor CEOs believe RRs will become financial advisors supported by salaried experts. (Chart 13) However, external competitors believe there will be reduced importance on the role of the RR. This may be wishful thinking on their part, but competitors also indicated that they will stress service that is less dependent on personal relationships. It might be useful to consider why competitors believe RRs will have reduced importance. One obvious reason is because they don't have such a salesforce and probably don't intend to build one. Another reason is that the RR system is a high cost method of distribution.

CHANGING ROLE OF THE ACCOUNT EXECUTIVE

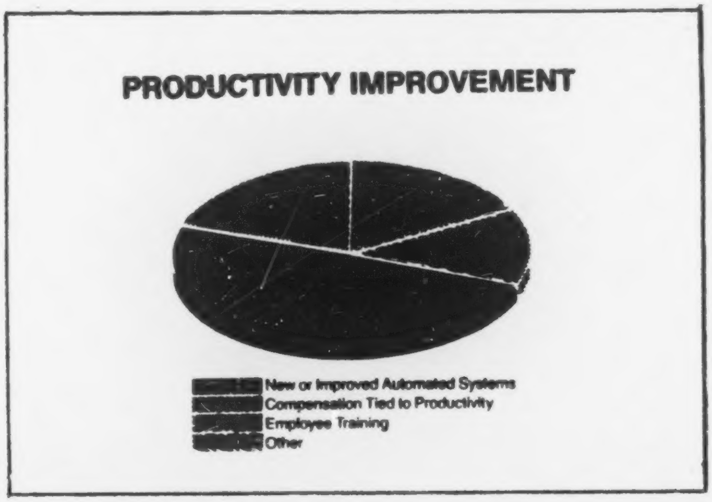
	PANEL	
	Securities CEO's	Competitors CEO's
Become a Financial Advisor	46%	54%
Have Reduced Importance Due to Technological Advance	11%	31%
Remain Unchanged	24%	11%
Have Increased Importance	15%	4%

The question might also arise whether an extensive branch distribution system makes any sense in the future. This is an advantage for the securities industry and a disadvantage for external competitors. However, it also has some disadvantages for the securities industry in terms of expenses. More and more firms are revisiting their compensation packages to make sure that the RR is being rewarded when he or she should be.

The securities industry has seen a dramatic escalation in costs in recent years. What did the Delphi participants have to say about that? (Chart 14)

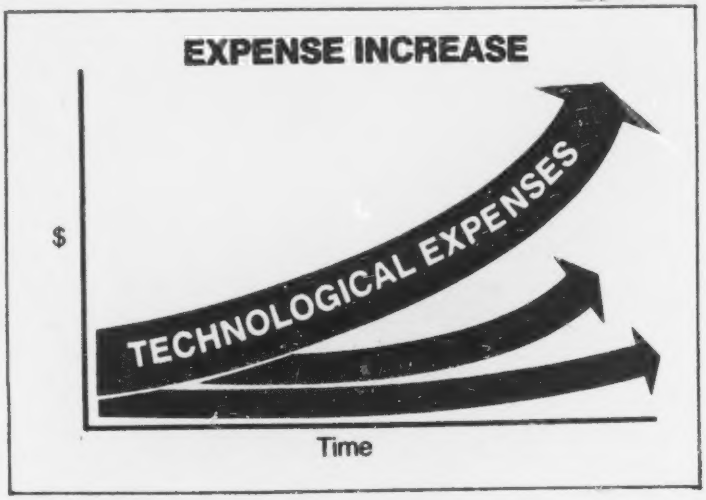


CEOs of securities firms and external competitors projected that cost control would be the most important factor affecting the profitability of securities firms in the late 1980s. To control expenses, industry management will focus on increasing employee productivity. This additional productivity will come from new or improved automated systems, followed by employee training programs and compensation tied to productivity. We are also more likely to see networking arrangements between firms as a way of reducing costs by sharing a service or facility. (Chart 15)



For any firm to control its costs, it must be able to accurately identify and categorize its cost components. The benefit to a firm of providing a particular product or service or the value of any one client is, in part, measured by their respective revenues and expenses. Improved cost collection and analysis techniques will enable management to make better decisions on how and where to deploy firm assets. This same concept should be extended to product line profitability. As product lines continue to grow almost to unwieldly levels for effective management control, this will become critical.

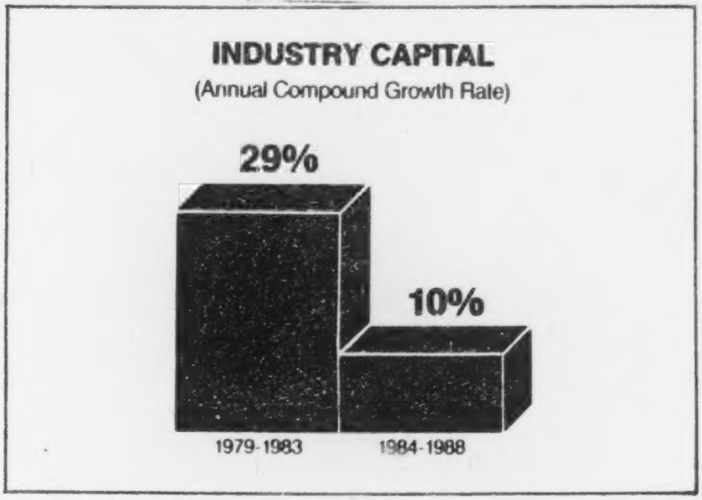
Technology costs will rise more than any other cost category. (Chart 16) Clearly, in the past, technology and communications costs have increased faster than other costs, which also have grown substantially. The industry projects that more and more money will continue to be spent on technology and communications in order to remain competitive.

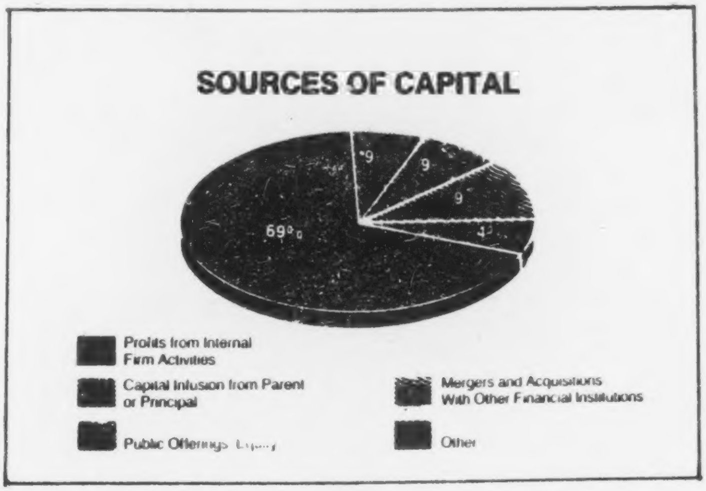


There is an uneasy feeling that these particular costs may be out of control. The reason for this is contained in another Delphi finding: Despite the increased costs and additional spending on technology, panelists believe that technology will not substantially improve their competitive advantage. So although firms have spent substantial sums on technology in the past and plan to do so in the future, it is clear that they really do not see how technology provides them with a competitive edge. They are not even certain how it translates to the bottom line, such as a reduction of expenses in terms of processing numbers of transactions that would not have been possible five years ago.

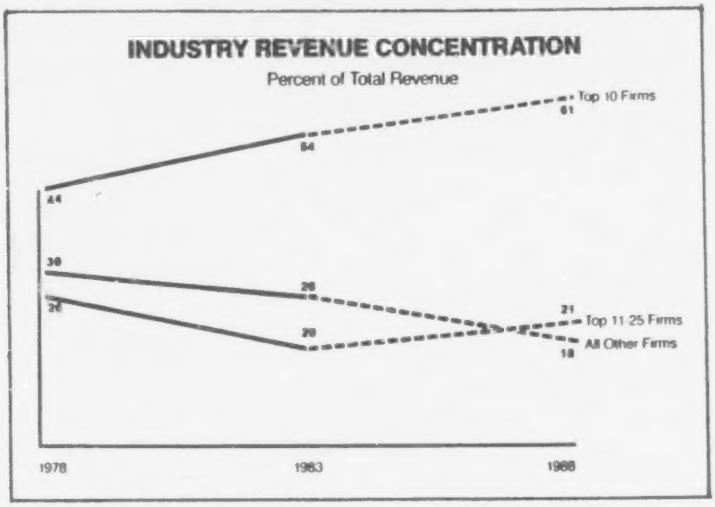
What did the Delphi panelists foresee as the overall financial health of the industry?

Capital is expected to grow about 10% from 1984-1988. This compares with 29% from 1979-1983. (Chart 17) Most of the additional capital, about 70%, is expected to come from retained earnings. (Chart 18) Big increases in capital in this industry took place after 1979. Since 1978, capital has increased by a factor of almost 4 in the securities industry.





In terms of concentration, Delphi panelists expect revenue concentration will continue to grow, from a 54% market share in 1983 to a projected 61% in 1988 for the top 10 firms. (Chart 19) This increased market share is projected to come at the expense of smaller firms. This says nothing at all about the profitability of different size firms. Profitability and firm size are unrelated in the securities industry.



Commissions are expected to decline in relative importance, while trading and investment profits will become more important. Actually, on an annual basis, in 1984 trading and investment profits were a larger percentage of revenues than commissions for the first time ever. This has been one of the most important factors affecting the structure and plans of the securities industry. Additional capital has been required and different products developed for hedging and other strategies that minimize risk, while firms are committing capital to positions. On the other side of the ledger, discounters have kept the level of increases in retail rates modest and intense competitive pressures have kept institutional rates at lower levels.

Given this emerging picture of the industry in the late 1980s, how will firms be managed. According to Delphi panelists, the management style of both securities firms and external competitors will have at least these four common characteristics: (1) centralized decision making, (2) long-term profit perspective, (3) higher levels of risk-taking, and (4) more entrepreneurialism. (Chart 20)

SIMILAR MANAGEMENT STYLES

- Centralized Decision Making
- Longer Term Profit Perspectives
- Higher Levels of Risk Taking
- More Entrepreneurialism

This is an overall picture and management style will no doubt vary with size, business and ownership of firms. For example, the deeper the pockets, the more likely a longer term profit perspective. In structuring a management approach, each firm needs to tailor it to its financial resources, quality of management, type of business, etc. We hope that this presentation and the Delphi Study will assist you in going further in discussing the implications with your own management team.

The Delphi Study, as mentioned earlier, is intended as a guide -- food for thought -- not as a precise road map, and it should be considered accordingly -- as another tool in planning for the future.

Edward I. O'Brien President SIA	Stephen G. Racioppo Partner Arthur Andersen & Co.	Jeffrey M. Schaefer Senior Vice President SIA

SECURITIES INDUSTRY STATISTICS

VOLUME

	March 1985	YEAR-TO-DATE 1985	March 1984	YEAR-TO-DATE 1984	% CHG. Y-T-D 1985 - 1984
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	102.6	113.2	84.3	95.5	18.5%
AMEX (MILS.)*	8.7	9.4	5.4	6.3	49.2
NASDAQ (MILS.)*	76.7	83.1	57.8	61.3	35.6
REGIONAL EXCHANGE (MILS.)*	20.2	19.6	12.4	14.1	39.0
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	76,916	242,187	63,905	209,003	15.9
AMEX (MILS.)	2,465	7,025	1,646	5,579	25.9
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,618	20,375	7,242	22,390	9.0
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,404	49,510	13,729	41,375	19.7
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.9	51.0	49.6	49.3	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	12,060	37,236	9,515	29,075	28.1
AMEX OPTIONS	2,914	9,131	3,591	9,973	(8.4)
COMMODITY	13,602	39,667	13,959	37,597	5.5

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	March 1985	March 1984	Basis Point Chg. Mar. 85 - Mar. 84
BOND BUYER INDEX (20 BOND)	9.77	9.97	(20)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.56	12.57	(1)
Baa CORPORATE	13.69	13.99	(30)
RATIO Aaa CORPS. TO Baa CORPS.	0.92	0.90	----
MUNICIPAL BOND YIELDS (MOODY'S)	9.77	9.41	36

PRICES

(END OF MONTH)

	March 1985	March 1984	% Change Mar. 85 - Mar. 84
DOW JONES INDUSTRIALS	1266.78	1164.89	8.7
STANDARD & POOR'S 500	180.66	159.18	13.5
NYSE COMPOSITE	104.60	91.67	14.1
AMEX MARKET VALUE INDEX	229.59	211.30	8.7
VALUE LINE COMPOSITE	194.53	182.19	6.8
NASDAQ COMPOSITE	279.20	250.78	11.3

UNDERWRITING
(DOLLARS IN MILLIONS)

	FIRST QUARTER 1985	FIRST QUARTER 1984	% CHANGE 1985 - 1984
CORPORATE FINANCING (Gross New Issues)			
Total	21,017	17,909	17.4%
Common Stock	4,237	2,271	86.6
# of Common Stock Issues	126	167	(24.6)
Preferred Stock	1,045	1,114	(6.2)
# of Preferred Stock Issues	15	19	(21.1)
Corporate Debt	15,734	14,524	8.3
# of Corporate Debt Issues	227	183	24.0
MUNICIPAL FINANCING (Gross New Issues)			
Total	22,707	22,731	(0.1)%
Notes	1,802	8,138	(77.9)
Bonds	20,905	14,593	43.3

MARGIN DEBT

	March 1985	March 1984	% Change Mar. 85 - Mar. 84
MARGIN DEBT OUTSTANDING ($MILS)	23,320	22,460	3.8%
NET CHANGE IN MARGIN DEBT ($MILS)	860	8,290	(89.6)
% OF ACCOUNTS WITH EQUITY UNDER 40%	11	11	-------

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1984	Yr.-To-Date 1984	Fourth Quarter 1983	Yr.-To-Date 1983	% Change 4th Q. 1984 4th Q. 1983	Yr.-To-Date % Change 1984 - 1983
REVENUE						
SECURITIES COMMISSION INCOME	$1,708	$7,095	$1,877	$8,326	(9.0)%	(14.8)%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,577	8,278	1,659	7,571	55.3	9.3
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	871	2,706	812	3,537	7.3	(23.5)
TOTAL REVENUE	8,518	31,216	7,245	29,515	17.6	5.8
TOTAL EXPENSES	8,015	29,608	6,928	25,706	15.7	15.2
NET INCOME BEFORE TAXES	503	1,608	317	3,809	58.7	(57.8)
PERCENT OF FIRMS SHOWING LOSS	36.2%	36.5%	37.3%	14.5%	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Keys to a Changing Securities World	SIA/Arthur Andersen Delphi study of the securities industry in the late 1980s, on which the presentations at the SIA Spring Meeting were based.	Communication Services Arthur Andersen & Co. 69 West Washington St. Chicago, Illinois 60602 $50 SIA members; $75 others
Sources--The Securities Executives' Guide to Products & Services	Classified buyer's guide to industry-related products and services. With more than 300 directory listings covering 80 different categories, this reference book includes hardware and software vendors, securities clearing firms, training institutions and travel agents.	SIA Publications Department
Fact Book 1984 NASD	Statistical review of NASDAQ activity in 1984, with certain historical data tracing developments since 1974. Lists individual performance data for each security in the NASDAQ National Market System as well as NASDAQ securities not in the System.	National Association of Securities Dealers, Inc 1735 K Street, N.W. Washington, D.C. 20006
Annual Financing Report	Reviews and ranks activity in Eurobond market and market for Euroloans and notes in 1984. Included are rankings of: lead and co-lead managers for all issues, all currencies, co-managers, bookrunners for dollar issues and non-dollar issues.	Euromoney Supplement April 1985
The Role of High Yield (Junk Bonds) in the Capital Markets & Corporate Takeovers: Public Policy Implications	Report examines high yield bond market, including risk-reward calculations, place of high yield instruments in overall structure of capital markets, and use of these securities in takeover situations. Existing regulatory situation is discussed along with policy options for additional legislative action.	Paper 85-694 E Congressional Research Service Library of Congress Economics Division Washington, D.C. 20540

ITEM	DESCRIPTION	SOURCE
The Tax Directory	Comprehensive reference to congressional policymakers, executive branch policymakers, tax-related organizations, and Treasury and IRS. Includes names of key people and staff, titles, phone numbers and mailing addresses.	Tax Notes Magazine 6830 North Fairfax Drive Arlington, VA 22213 $7.50 Prepaid
Managers of America's Wealth	Issue based on annual survey of largest money managers. Profiles of over 900 managers which include investment approach, asset mix, assets managed, and key people.	Pensions & Investment Age Special Profiles Issue 5/6/85
Annual Report 1984	Focuses on the uneven economic performance of the world economy in 1984 and present problems and future risks. Reviews four troublesome factors that could undermine world progress: U.S. deficit, slow growth in Europe, protectionism, and the vulnerability of the LDCs.	Public Relations Federal Reserve Bank of New York 33 Liberty Street New York, N.Y. 10045
"The Troubled Market in Federal Securities"	Reviews the workings of the government securities markets, collapse of ESM and Bevill Asset Management, and suggested remedies entailing increased regulation. Concludes: Too many rules would be worse than too few. Author's solution: Give the NY Fed authority to examine books of any government securities dealer.	Fortune 5/13/85
"Commodity Prices in the Current Recovery"	Reviews the recent behavior of commodity prices in cyclical and longer term context, analyzes determinants of current expansion, and discusses medium-term price prospects for a few commodities.	Quarterly Review Federal Reserve Bank of New York

Securities Industry
Trends

ANNUAL SUBSCRIPTION
$36.00 member • $60.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1

Vol. XI, No. 4 June 28, 1985

The 1984 Performance of the Securities Industry by Firm Category

Highlights

1. In 1984, profitability dropped for all firm categories. Only two categories were profitable while the others were either marginally profitable or actually unprofitable. The after-tax ROEs were: Large Investment Banks (LIB), 17%; New York City Regionals (NYC), 11%; and Regionals Based Outside N.Y. (REG), 4%. National Full-Line (NFL) and Discounters (DIS) had losses with a pre-tax ROE of (2)% each.

2. LIB was the most profitable firm category in 1984 because of the emphasis on principal business in debt securities and institutional customers. REG, NFL and DIS suffered last year being more dependent on dealing with retail clients.

3. NYSE and NASD DIS firms' market share of retail commissions and retail share volume rose in 1984. Their estimated market share of retail commissions increased in 1984 to 9.6% from 8.5% in 1983. Their estimated market share of retail share volume rose last year to 19.2% compared to 17.0% in 1983.

4. DIS firms' market share of total revenues declined slightly to 1.2% in 1984 because of their emphasis on agency business - - commissions and margin interest. This may help explain why DIS firms are seeking to add new products and services.

5. Industry profitability rose in the 1Q 1985 largely because of increased activity in the equity business. Annualized after-tax ROE was 16% in the 1Q 1985 compared with 7% in 1984. Factors are in place for ROE to rise appreciably in 1985 as interest rates have fallen and cost containment programs have been instituted at securities firms.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 608-1500

Introduction

Five years of high profitability in the securities industry came to an abrupt halt in 1984. All firm categories suffered a significant decrease in profitability. This issue of Trends examines the 1984 performance of the securities industry by firm category, including revenues, expenses and profitability. The firm categories analyzed are National Full-Line (NFL), Large Investment Banks (LIB), New York City Based Regionals (NYC), Regionals Based Outside of N.Y. (REG) and Discounters (DIS).

Profitability

In 1984, the securities industry's after-tax ROE dropped to 7%, the lowest level since 1977.[1] The industry had enjoyed five previous years of unprecedented profitability, with after-tax ROE averaging 21% from 1979 to 1983. Thus, the 1984 results reflected a discouraging reversal in the fortunes of the securities industry.

Profitability dropped in 1984 for all firm categories. The ROE for some categories plunged to levels not experienced since 1974, or since comparable data by firm categories were tabulated.

Despite robust economic growth in 1984, only a couple of firm categories were profitable. Others were marginally profitable or actually unprofitable. This paper will cover the decreases and divergencies in the profitability performances among firm categories during a year when the economy expanded at its most rapid rate since 1951.

LIB was the most profitable firm category in 1984, with an after-tax ROE of 17% (Table 1). NYC Regionals had the second highest after-tax ROE, 11%. REG was marginally profitable while the NFL and DIS sustained actual losses. The dispersion in ROEs among the categories widened last year. In 1983, the after-tax ROEs ranged from 15% to 27%, with a median of 24%. In 1984, the after-tax ROEs ranged from about (2)% to 17%, with a 4% median.[2]

---

[1] The 1984 profitability performance of the securities industry was analyzed in "The 1984 Performance of the Securities Industry," Trends, April, 1985.

[2] The NFL and DIS categories each had a 1984 pre-tax ROE of (2)% which is compared to the after-tax ROEs of the other categories.

Table 1

After-Tax Return-on-Equity

Firm Categories	1983	1984	Change in Percentage Points, 1983-1984
National Full-Line	15.2%	(2.4)%[1]	(17.6)
Large Investment Banks	23.7	16.8	(6.9)
N.Y.C. Based Regional	27.3	10.8	(16.5)
Regional	21.9	3.7	(18.2)
Discounter[2]	22.7	(2.4)[1]	(25.1)
Industry[3]	19.8%	7.2%	(12.6)

---

[1] Pre-tax ROE

[2] NYSE and NASD Discounters

[3] For NYSE firms doing a public business.

( ) Negative

Source: Securities Industry Database

Component analysis provides insight about why the ROE for each of the various firm categories declined in 1984 (Table 2). NFL firms suffered a loss, as shown by the negative profit margin. Their asset turnover dropped significantly, while the leverage ratio for these firms rose substantially. The LIB category was the most profitable last year and had both the highest profit margin and leverage ratio. As always, asset turnover was the lowest of the firm categories.

The NYC firms' profit margin dropped even more than the NFL's; however, their asset turnover decreased less than that of all other categories except LIB and their leverage ratio rose modestly. The REG firms' profit margin and asset turnover ratio fell more than all other categories except for the DIS firms which suffered the sharpest declines in these ratios and were unprofitable as a group.

Table 2

Component Analysis of After-Tax Return on Equity

Firm Categories		Profit Margin ($)	x Asset Turnover ($)	x Leverage	x Tax Retention Rate (%)	= ROE (%)
Nat'l Full Line	1982	.0881	.2681	12.6	54.0%	16.1%
	1983	.0858	.2400	13.7	54.0	15.2
	1984	(.0083)	.1787	16.0	-	(2.4)1/
Lg. Invst. Bks.	1982	.1736	.1045	30.2	54.0	29.6
	1983	.1673	.0872	30.0	54.0	23.7
	1984	.1144	.0837	32.5	54.0	16.8
New York Based	1982	.1403	.2257	13.7	54.0	23.4
	1983	.1834	.2267	12.2	54.0	27.3
	1984	.0886	.1779	12.7	54.0	10.8
Regional	1982	.1108	.3439	9.4	54.0	19.4
	1983	.1265	.4083	7.8	54.0	21.9
	1984	.0259	.3235	8.1	54.0	3.7
Discounter2/	1982	.1360	.4932	7.30	54.0	26.4
	1983	.1396	.5005	6.69	54.0	25.2
	1984	.0034	.3873	6.48	54.0	0.5
Industry	1982	.1308	.1787	17.3	54.0	21.9
	1983	.1294	.1631	17.3	54.0	19.8
	1984	.0515	.1348	19.1	54.0	7.2

1/Pre-tax ROE

2/NYSE Discounters

( )Negative

Firm Categories

In 1984, profitability was highest for the firm category most dependent on principal business and institutional customers, LIB, and significantly lower or unprofitable for the other firm categories more dependent on dealing with retail clients.

National Full-Line

The NFL firm category sustained a pre-tax loss of $118 million. Pre-tax ROE for this category was (2)%. Data on the NFL firm category are available from SIA starting with 1973. Last year marked the first time that an actual loss occurred. Total revenues rose only 1% while expenses climbed nearly 12% (Table 3). Proximate non-interest revenues (excludes margin interest and other-related revenues) fell 6% and non-interest expenses decreased 3%.[3] The NFL category's loss resulted because of a downturn in the agency business and the inability to cut costs enough to compensate for lower revenues. With interest expense rising 61%, generating sufficient revenues to offset such pressure was a formidable task.

Revenues

Proximate non-interest revenues dropped mainly because of the lack of retail customer interest in equities, which resulted from the uncertain economic environment and high real interest rates available on alternative investments. Five of the nine non-interest revenue sources decreased by almost $1.2 billion last year. More than 90% of this fall resulted from the drop in equity related revenue sources. Commissions were responsible for 46% of this drop; market making OTC, 17%; mutual funds, 15%; and underwriting, entirely because of the plunge in equity underwriting, accounted for 9%. Revenues from the four other non-interest sources grew by $500 million, but most of this increase was not related to equity business. Other-unrelated revenues were responsible for almost 50% of this increase; trading profits, solely because of the activity in debt securities, generated another 29%; investment profits, 15%; and account supervision, 7%.

The 19% fall in commissions for NFL firms was steeper than the industry's 15% drop. This occurred because of the retail orientation and customer base of NFL firms. LIB firms are institutionally directed and NYC firms have a heterogeneous

---

[3] A comparison of proximate non-interest revenues and non-interest expenses helps to better understand the reasons for the change in profitability by minimizing the effects of interest rate trends on revenues and expenses.

Table 3

National Full-Line Firms
Revenues and Expenses, 1983 and 1984[1]

(millions of dollars)

	1983	1984	Change, 1983-1984 Dollars	Change, 1983-1984 Percent
REVENUES				
Commissions	$3,629	$2,936	$(693)	(19)%
Listed equities on an exchange	2,656	2,163	(493)	(19)
Listed equities, OTC	42	30	(13)	30)
Options	487	478	(9)	(2)
All Other	443	265	(178)	(40)
Trading Profits	2,892	3,038	146	5
Market Making - OTC equity	780	526	(254)	(33)
Debt Securities	1,991	2,338	347	17
Options on Nat'l Exchange	0[2]	3	3	1,400
All Other	121	170	49	41
Investment Profits	37	110	73	200
Underwriting	1,593	1,457	(136)	(9)
Equity	277	57	(220)	(79)
Debt	1,316	1,400	84	6
Margin Interest	1,201	1,547	346	29
Mutual Fund Sales	777	550	(228)	(29)
Account Supervision	250	285	36	14
Research	2	(1)	(3)	(157)
Commodities	703	608	(95)	(14)
Other-Related	1,525	1,979	455	30
Other-Unrelated	316	560	244	77
TOTAL REVENUES	$12,923	$13,066	$143	1%
EXPENSES				
Employment	$6,078	$5,976	$(102)	(2)%
RR Compensation	3,451	3,246	(205)	(6)
Clerical & Administrative	2,627	2,730	103	4
Floor Brokerage & Clearance	362	347	(15)	(4)
Fixed Expenses	1,701	2,124	422	25
Communications	923	1,066	143	15
Occupancy & Equipment	630	861	231	37
EDP Equipment	148	197	49	33
Promotional Costs	468	459	(9)	(2)
Interest Expense	1,757	2,822	1,065	61
Errors and Bad Debt	153	145	(8)	(6)
Non-recurring Charges	94	10	(84)	(89)
Partners & Stockholders	177	191	13	8
Regulatory Fees and Expenses	46	49	3	6
Other Expenses	980	1,063	85	9
TOTAL EXPENSES	$11,814	$13,184	$1,371	12%
PRE-TAX NET INCOME	$1,109	$(118)	$(1,227)	(111)%

---

[1] Discrepancies may exist due to rounding.
[2] Less than $500,000.
( ) Negative
Source: Securities Industry Database

clientele as some of the larger firms focus on money management and institutional business. In 1984, the industry's retail commissions were estimated to have plunged 26%, but institutional commissions fell by less than 8%.[4] NFL commissions also decreased more than REG (16%) and DIS (12%).

NFL was one of only two firm categories to experience an increase in trading profits last year. However, trading profits for NFL firms increased a modest 5%, the smallest gain since 1977. From 1977 to 1983, their compound annual growth rate for trading profits was 33%. Trading profits as a proportion of NFL total revenues rose from 15% in 1977 to 23% in 1984. Debt securities were responsible for 87% of the 1984 increase in trading profits. On the other hand, trading profits from OTC market making plunged 33% from 1983.

Underwriting revenues for NFL firms decreased significantly less, 9%, than for the industry, 24%. This comparatively better performance resulted partly because of Shearson/American Express' 1984 acquisition of Lehman Brothers and the large share of the record volume of long-term municipal underwriting garnered by NFL firms. Shearson's corporate underwriting ranking rose from twelfth in 1983 to sixth in 1984, and its municipal underwriting ranking rose from seventh in 1983 to fourth in 1984.[5] The NFL firm category was the only category to experience an increase in debt underwriting revenues. NFL firms' 1984 proportion of the record volume of long-term municipal underwriting was 36%, slightly greater than the 34% in 1983.

Other-related revenues rose by 30%, significantly greater than total revenues which increased only 1%. Since 1979, other-related revenues have increased for NFL firms at a compound annual growth rate of 38%. As a result, their proportion of NFL total revenues has risen from 4% in 1977 to 15% in 1984. Interest on the repo business is believed to be the largest component of this revenue line. The average amount of reverse repos for NFL firms rose from $13.6 billion in 1983 to $24.7 billion in 1984.

---

[4] Retail commissions are estimated to have fallen from $3.3 billion in 1983 to $2.5 billion in 1984, a 26% drop. Institutional commissions are estimated to have declined from $5.0 billion in 1983 to $4.6 billion in 1984, an 8% decrease. For data on total commissions and estimated percentages of retail and institutional commissions see SIA, Trends, April 1985, pages 8 and 10.

[5] Sources: Institutional Investor and Public Securities Association.

Expenses

The increase in NFL firms' expenses slowed significantly in 1984 because of decreases in certain expenditure items as business activity fell and management employed efforts to limit costs. However, this slowdown in expense growth was not sufficient to prevent a loss from occurring as total revenues rose minimally from 1983. NFL firms have high fixed costs related to their branch office system. In addition, prior commitments to expand branch office systems and to improve equipment for competitive reasons were continued.

Total expenses rose by 12% in 1984, the smallest increase since 1977. NFL firms' total expenses had increased at a compound annual growth rate of 28% from 1977 to 1983. Interest expense climbed 60%, representing almost 70% of the total 1984 rise in expenses. Non-interest expenses increased only 3%.

Employment expenses decreased 2% because of a 6% fall in RR compensation due to declining production. Nevertheless, the average number of RRs and some other income producing employees continued increasing last year, to 46,600 from 42,600 in 1983. Clerical and administrative employee expenses rose 4%, as the average number of these employees also increased, to 75,900 from 69,960 in 1983. However, non-income producing employment declined during the last half of 1984.

So-called fixed expenses continued to climb for NFL firms despite the lagging business. Last year, total fixed expenses rose by 25%. From 1977 to 1983, so-called fixed expenses for NFL firms increased at a compound annual growth rate of 24%. Occupancy and equipment rose 37% last year. EDP equipment costs climbed 33% due in part to the growth in mini-computers for departmental systems and the switch from leasing to the purchase of equipment for tax purposes. Communications expenses rose 15% given the need for better quality equipment and increased usage of communication lines.

Large Investment Banks

LIB, with an after-tax ROE of 17%, was the most profitable firm category in 1984. Since 1974, relative to ROE, LIB was the highest ranked firm category for nine years and second highest in one year.6/ In analyzing the LIB's 1984 performance, it should be noted that there were only ten firms in this category in the last-half of the year compared with eleven firms in 1983.7/

LIB's 1984 after-tax ROE dropped considerably from the 1983 level of 24%. Total revenues rose 23% and total expenses climbed 31%, mostly because of higher average interest expense (Table 4). Proximate non-interest revenues grew 7% last year compared with 28% in 1983, while non-interest expenses increased 4% compared with 38% in 1983. Nevertheless, LIB was the only firm category to enjoy an increase in proximate non-interest revenues last year.

Revenues

In 1984, LIB fared better than the other firm categories mainly because of differences in business mix. LIB is significantly more dependent on principal business than the rest of the industry. For example, trading profits accounted for 34% of LIB's total revenues last year, compared with 20% for the rest of the industry. Within trading profits, LIB emphasizes debt securities more than, and OTC market making less than, other firm categories.

In 1984, firms earned significant trading profits on debt securities as long-term interest rates fell during the last-half of the year. As a result, LIB's trading profits climbed a reported 25%, with debt securities soaring by a reported 34%. In contrast, their trading profits from OTC market making plunged by 50%.

LIB also relies heavily on other-related revenues. Last year, other-related revenues accounted for 33% of LIB's total revenues, compared with 14% for the rest of the industry.

6/ DIS's ROE is included in this comparison only since 1982 when SIA began tracking and reporting publicly on this firm category.

7/ Increases in LIB revenues and expenses in 1984 would have been somewhat greater than those reported and decreases would have been slightly smaller if 1983 data had been adjusted for the same number of firms as in 1984.

Table 4

Large Investment Banks
Revenues and Expenses, 1983 and 1984[1]
(millions of dollars)

			Change, 1983-1984	
	1983	1984	Dollars	Percent
REVENUES				
Commissions	$1,216	$1,068	$(148)	(12)%
Listed equities on an exchange	1,049	915	(134)	(13)
Listed equities, OTC	19	2	(16)	(89)
Options	67	70	3	5
All Other	82	81	(1)	(2)
Trading Profits	2,708	3,397	698	25
Market Making - OTC equity	244	119	(125)	(51)
Debt Securities	2,013	2,702	688	34
Options on Nat'l Exchange	42	(3)	45	(107)
All Other	409	580	171	42
Investment Profits	365	364	(1)	(0)[2]
Underwriting	1,051	734	(317)	(30)
Equity	230	98	(133)	(58)
Debt	821	636	(184)	(22)
Margin Interest	269	385	116	43
Mutual Fund Sales	10	11	1	14
Account Supervision	85	111	27	32
Research	0[3]	0[3]	0	0
Commodities	62	65	3	4
Other-Related	1,984	3,327	1,342	68
Other-Unrelated	458	640	181	35
TOTAL REVENUES	$8,209	$10,103	$1,894	23%
EXPENSES				
Employment	$1,904	$1,926	$22	1%
RR Compensation	857	786	(71)	(8)
Clerical & Administrative	1,048	1,140	92	9
Floor Brokerage & Clearance	203	216	13	6
Fixed Expenses	505	605	100	20
Communications	231	261	30	13
Occupancy & Equipment	206	259	53	26
EDP Equipment	68	85	17	25
Promotional Costs	110	140	30	27
Interest Expense	3,358	5,318	1,960	58
Errors and Bad Debt	29	21	(8)	(3)
Non-recurring Charges	0	0[3]	0[3]	0[2]
Partners & Stockholders	289	301	12	4
Regulatory Fees and Expenses	23	28	5	24
Other Expenses	415	394	(22)	(5)
TOTAL EXPENSES	$6,836	$8,948	$2,112	31%
PRE-TAX NET INCOME	$1,373	$1,155	$(218)	(19)%

---

[1] Discrepancies may exist due to rounding
[2] Percent change was less than 0.5%.
[3] Less than $500,000.
( ) Negative
Source: Securities Industry Database

Interest on the repo business is the largest proportion of these revenues. However, merger and acquisition fees and private placement fees are also included. In 1984, M&A activity and private placements reached record levels.[8]

LIB depends on commissions and other equity related revenue sources much less than the rest of the industry. In 1984, commissions accounted for 11% of LIB total revenues compared to 29% for the rest of the industry. In addition, LIB generates institutional commissions which decreased much less last year than retail commissions.

LIB experienced a reported 30% drop in underwriting revenues, significantly greater than the rest of the industry's 21% decrease. Revenue from equity underwriting plunged nearly 60% compared with 1983, while revenue from debt underwriting decreased 20%.[9]

Expenses

Total expenses escalated more for LIB (31%) than the rest of the industry (15%) largely because of a 60% increase in interest expense. The jump in interest expense accounted for more than 90% of the climb in LIB total expenses.

So-called fixed expenses rose a reported 20% and were responsible for 55% of the increase in non-interest expenses. Since 1977, fixed expenses have increased at a compound annual growth rate of about 19%. Occupancy and equipment and EDP equipment costs had the largest increases, followed by communications.

Regional

REG firms' after-tax ROE dropped to 4% in 1984 from 22% in 1983, representing the sharpest drop in profitability among the categories except for DIS. This decrease in ROE occurred principally because of REG's relatively greater dependence on commissions and underwriting revenues, both of which fell mostly because of the weak equity market (Table 5). The REG category suffered the largest decline in both total revenues (11%) and proximate non-interest revenues (18%) among the categories while total expenses remained at the 1983 level and non-interest expenses fell 5%.

---

[8] Source for M&A activity is W.T. Grimm and for private placements, Dealers' Digest.

[9] This drop in total underwriting revenues would not have been as sharp if these revenues were adjusted for the acquisition of Lehman Brothers.

Revenues

The falloff in underwriting revenues and commissions accounted for more than 95% of the plunge in proximate non-interest revenues. Underwriting revenues plunged $235 million, while commissions dropped $231 million. The absolute fall in underwriting revenues was almost evenly distributed between decreases in equity underwriting revenue ($115 million) and debt underwriting revenue ($120 million).

Although REG's percentage decrease in equity underwriting revenue was in-line with that of the total industry, the drop in debt underwriting revenue was sharper. Debt underwriting revenue declined despite the record volume in municipal underwritings. The increase in Rule 415 debt offerings explains part of the falloff. Rule 415 debt offerings accounted for 56% of corporate debt offerings in 1984. These underwritings are often the product of the more heavily capitalized firms who manage the distribution without forming a syndicate. As a result, REG firms are often excluded from such deals. Underwriting revenues also fell because of the plunge in equity volume. From 1979 to 1983, underwriting revenues as a proportion of REG's total revenues rose steadily from 9% to 17%; however, this proportion dropped to 12% in 1984.

Trading profits increased consistently as a proportion of REG's total revenues from 1979 to 1983. However, in 1984 they accounted for the same proportion of total revenues, 16%, as in 1983. Much of REG's trading activity is directed to OTC market making and the adverse conditions in the 1984 OTC market translated to diminished profits for REG firms.

Expenses

Cost controls were implemented by REG firms in 1984 as total expenses were held in-line with 1983, despite a 44% increase in interest expense. Non-interest expenses actually decreased by 5%.

Employment expenses fell by 12%. RR compensation dropped 18% given lower production, and clerical and administrative employee expenses declined by 0.5%. Average employment of RRs and other income producing employees rose 7% to 15,466, and non-income producing employment increased 4% to 20,716.

REG's fixed expenses increased only 13%, significantly less than all other categories and the industry's 22% climb. In addition, the 1984 rise represented a significant slowdown from the 21% growth in fixed expenses in 1983.

Table 5

Regional Firms
Revenues and Expenses, 1983 and 1984[1/]
(millions of dollars)

	1983	1984	Change, 1983-1984 Dollars	Change, 1983-1984 Percent
REVENUES				
Commissions	$1,406	$1,176	$(231)	(16)%
Listed equities on an exchange	877	729	(148)	(17)
Listed equities, OTC	28	12	(16)	(59)
Options	113	129	16	14
All Other	388	306	(82)	(21)
Trading Profits	596	530	(65)	(11)
Market Making - OTC equity	254	174	(81)	(32)
Debt Securities	260	296	36)	14
Options on Nat'l Exchange	4	1	(3)	(85)
All Other	82	63	(19)	(24)
Investment Profits	34	17	(17)	(50)
Underwriting	631	396	(234)	(37)
Equity	185	71	(115)	(62)
Debt	445	325	(120)	(27)
Margin Interest	304	400	96	32
Mutual Fund Sales	138	161	23	17
Account Supervision	46	44	(3)	(6)
Research	11	6	(44)	(41)
Commodities	43	41	(2)	(4)
Other-Related	340	410	71	21
Other-Unrelated	73	58	(14)	(20)
TOTAL REVENUES	$3,621	$3,240	(381)	(11)
EXPENSES				
Employment	$1,652	$1,452	$(190)	(12)%
RR Compensation	1,034	847	(187)	(18)
Clerical & Administrative	608	605	13	(1)
Floor Brokerage & Clearance	174	166	(8)	(4)
Fixed Expenses	453	512	61	13
Communications	236	262	26	11
Occupancy & Equipment	167	197	29	18
EDP Equipment	50	55	5	10
Promotional Costs	97	98	1	1
Interest Expense	295	424	129	44
Errors and Bad Debt	28	23	(5)	(16)
Non-recurring Charges	2	12	10	485
Partners & Stockholders	258	221	(36)	(16)
Regulatory Fees and Expenses	27	29	2	6
Other Expenses	187	215	28	15
TOTAL EXPENSES	$3,163	$3,155	$(7)	(0.2)%
PRE-TAX NET INCOME	$457	$84	$(373)	(82)%

1/ Discrepancies may exist due to rounding.
Source: Securities Industry Database

New York City Regionals

NYC firms' 11% after-tax ROE was the second highest among firm categories in 1984, albeit significantly lower than the 23% of 1983. Since 1974, NYC Regionals have been the second most profitable category. These firms maintained reasonable profitability in 1984 because of a comparatively modest increase in expenses given the small decrease in revenues. Although total revenues declined by 3%, expenses rose by only 8% (Table 6). Interest accounted for nearly 50% of the rise in total expenses. Proximate non-interest revenues fell 9%, and non-interest expenses increased by less than 3%.

Revenues

Proximate non-interest revenues were reduced in 1984 by lower commissions, trading profits and underwriting. However, the drop in revenues was limited by the climb in fees for account supervision and other-unrelated revenues.

Only DIS rely on commissions for a higher proportion of their revenues than NYC. Commissions last year accounted for 36% of NYC total revenues, compared with 22% for the rest of the industry. NYC commissions fell 14% in 1984, thus representing almost 50% of the drop in proximate non-interest revenues. "Other" commissions suffered a steeper fall in revenue ($64 million) than listed equities executed on an exchange ($59 million). Included in "other" are commissions earned on OTC option transactions, agency business in OTC stocks and debt transactions. Commissions on listed equities executed on an exchange declined only 10% last year, the smallest decrease among firm categories.

Trading profits are a less important revenue source for NYC firms than the rest of the industry. For example, last year they accounted for 12% of this category's total revenues compared with 25% for the rest of the industry. Trading profits for NYC firms fell 20% in 1984, causing proximate non-interest revenues to drop by nearly 25% from the 1983 level. The fall in NYC firms' trading profits contrasts with the industry's 11% increase. Losses in OTC market making as well as "other" contributed to the drop in trading profits.10/ In addition, trading profits on debt securities rose only 8% compared with the industry's 25% climb.

10/ "Other" trading profits include market making on exchange listed equities executed on an exchange, unlisted options and market value of proprietary securities deposits with clearing organizations.

Table 6

New York City Regionals
Revenues & Expenses, 1983 and 1984[1]

			Change, 1983-1984	
	1983	1984	Dollars	Percent
EVENUES				
ommissions	794	681	(114)	(14)%
Listed Equities, on an exchange	567	508	(59)	(10)
Listed Equities, OTC	12	18	6	52
Options	44	47	3	6
All Other	172	108	(64)	(59)
rading Profits	259	206	(53)	(21)
Market Making - OTC Equities	73	32	(42)	(57)
Debt Securities	105	113	9	8
Options on Nat'l Exchange	9	19	10	110
All Other	74	42	(32)	(43)
nvestment Profits	73	63	(10)	(14)
nderwriting	87	34	(53)	(61)
Equity	38	11	(27)	(72)
Debt	49	23	(26)	(52)
argin Interest	175	230	56	32
utual Fund Sales	11	9	(3)	(25)
ccount Supervision	68	115	47	69
esearch	4	3	(1)	(36)
ommodities	13	17	5	39
ther-Related	222	241	19	9
ther-Unrelated	48	107	60	125
OTAL REVENUES	$1,754	$1,705	$(49)	(3)%
XPENSES				
mployment	$606	$586	$(20)	(3)%
RR Compensation	307	264	(45)	(15)
Clerical & Administrative	299	322	23	8
loor Brokerage & Clearance	141	140	(1)	(1)
ixed Expenses	166	201	35	21
Communications	74	86	12	17
Occupancy & Equipment	65	86	21	32
EDP Equipment	27	27	0[2]	0[3]
romotional Costs	29	35	6	20
nterest Expenses	258	347	89	35
rrors and Bad Debts	7	9	3	36
on-recurring Charges	0[2]	4	3	800
artners & Stockbrokers	97	84	(12)	(13)
egulatory Fees and Expenses	18	13	(4)	(25)
ther Expenses	112	137	25	23
OTAL EXPENSES	$1,433	$1,554	$121	8%
RE-TAX NET INCOME	$321	$151	$(170)	(53)%

/ Discrepancies may exist due to rounding

/ Less than $500,000.

/ Less than 0.5%.

ource: Securities Industry Database

NYC Regionals also depend less on underwriting revenues than the other categories except for DIS firms. Last year, only 2% of NYC revenues were generated from underwriting, compared with 8% for the rest of the industry. Underwriting revenues plunged 60% in 1984 for the NYC category, compared to a 24% drop for the industry. NYC Regionals sustained a greater falloff because of their comparatively greater involvement in equity underwriting.

However, the diversification of NYC firms' revenues limited the drop in proximate non-interest revenues. Fees for account supervision are a much more important revenue source for NYC firms than the other categories and they rose by nearly 70% last year. In addition, revenues unrelated to securities climbed by 125%. In 1984, revenues from these two sources rose by $106 million and partially offset the $235 million drop in other areas.

Expenses

NYC firms had the second smallest change, a 3% increase, in non-interest expenses in 1984 among the firm categories. REG firms' non-interest expenses decreased 5%. Decreases in employment expenses and partners and stockholder costs dampened the rise of non-interest expenses. However, comparatively large increases were experienced for so-called fixed expenses and other expenses.

Employment expenses decreased 3% based on a 15% drop in RR compensation. The NYC firms' RR compensation fell more than the other categories except for REG firms because of the plunge in underwriting revenues.

So-called fixed expenses rose 20% for NYC firms in 1984, about the same increase as in 1983 when profitability was much higher. In 1984, occupancy and equipment climbed the fastest followed by communications. EDP equipment costs actually declined.

Discounters

SIA began analyzing the performance of discounters in 1982 because of widespread interest in this segment of the industry. Included in our analysis are DIS firms which are members of both the NYSE and NASD. NASD DIS firms account for more than 20% of total DIS commissions and revenues (Table 7). Revenues, expenses and income for NYSE members and sole NASD members must be aggregated to examine the DIS category's market shares of retail commissions and total revenues (Table 8).

Table 7

NYSE and NASD Discounters Revenues, Expenses and Income, 1984

(millions of dollars)

	NYSE	NASD	Industry
Revenues	$356.4	$102.7	$459.1
Commissions	232.3	64.8	297.1
Expenses	355.3	107.8	463.1
Pre-tax Net Income	1.2	(5.3)	(4.1)

Table 8

Industry Revenues, Expenses and Income, 1984

(millions of dollars)

	NYSE	NASD	Industry
Revenues	$31,216.0	$6,126.8	$37,342.8
Commissions	7,094.6	1,769.6	8,864.2
Expenses	29,608.2	5,601.2	35,209.4
Pre-tax Net Income	1,607.8	525.6	2,133.4

The DIS category suffered a loss in 1984 because of retail customers' diminished interest in equities. Of all the firm categories, this group is the most dependent on agency business and the least diversified. For example, during the past three years, commissions and margin interest revenue accounted for 86% of the DIS category's total revenues compared with 35% for the rest of the industry. Commissions produced 68% of DIS firms' total revenues contrasted to 26% for the rest of the industry. Margin interest revenue amounted to 17% of this category's total revenues as opposed to 9% for the rest of the industry.[11/]

[11/] Estimates based upon NYSE discounters only.

The DIS category suffered a pre-tax loss of $4 million in 1984 when its pre-tax ROE was (2)%, compared with an after-tax ROE of 22% in 1983. Revenues declined 2% as commissions dropped 12%. Expenses rose by 12% because of the climb in interest as well as so-called fixed expenses. Interest expense climbed nearly 70%, accounting for 40% of the rise in total expenses.[12] So-called fixed expenses increased nearly 45%, representing almost 35% of the rise in total expenses.

NYSE and NASD DIS firms' market share of retail commissions and retail share volume rose in 1984 as their retail commission business apparently fell less than the rest of the industry. The DIS category's retail commissions decreased 12% compared with the rest of the industry's 24% fall. As a result, their estimated market share of retail commissions increased in 1984 to 9.6% from 8.5% in 1983 (Table 9). Their estimated market share of retail share volume rose last year to 19.2% compared to 17.0% in 1983.[13]

The DIS category's larger 1984 market share occurred partly because of increased promotional activity. Promotional costs for DIS firms climbed 19% compared with less than 5% for the rest of the industry. Among the categories, NFL and REG promotional expenses remained essentially at their 1983 levels. In addition, customers of DIS firms appear to be more active traders. Nevertheless, DIS firms' market share of total revenues declined slightly to 1.2% in 1984 because of the lack of diversification. This may help explain why DIS firms are seeking to add products and services.

12/ Interest expenses and so-called fixed expenses were estimated based upon NYSE DIS data.

13/ Estimated based on assumption that discounters' commission rates are about one-half that of full-service firms'.

Table 9

NYSE and NASD Discounters' Market Share, 1982 to 1984 [1/]
(millions of dollars)

	1982	1983	1984
Industry Commissions	$6,956.6	$9,992.0	$8,865.0
Estimated Retail Commissions	3,394.8	3,996.8	3,085.0
Discounters' Commissions	224.3	338.4	297.1
Discounters' Market Share of Retail Commissions	6.6%	8.5%	9.6%
Industry Gross Revenues	$26,865.3	$34,887.1	$37,344.9
Discounters' Gross Revenues	338.6	466.1	459.1
Discounters' Market Share of Gross Revenues	1.3%	1.3%	1.2%

[1/] Revised 1982 and 1983 data.

First-Quarter 1985

Industry profitability rose in the 1Q 1985 to its highest quarterly level since the 2Q 1983. Annualized after-tax ROE was almost 16%. In addition, 83% of NYSE member firms were profitable, a significant improvement from the 65% in 1984. Compared with 1984, annualized total revenues increased 15% while total expenses rose less than 9%.

The increased interest in equities was responsible for more than 60% of the rise in proximate non-interest revenues. The attraction of equities improved because of the drop in interest rates. As a result of the renewed interest in equities, there were significant increases in commissions, trading profits from market making OTC, equity underwriting, net margin interest income and mutual fund sales. In the following analysis of the industry's 1Q 1985 performance, all 1Q 1985 data are compared with 1984 average quarterly data.

Revenues

Commissions climbed 22% in the 1Q 1985, accounting for 32% of the rise in proximate non-interest revenues. On the NYSE, AMEX and Regional exchanges, average daily share volume rose 30% to 142.4 million shares in the 1Q 1985 from 111.4 million shares in 1984. Similarly, the dollar value of shares traded increased 30%, to $296.2 billion in the 1Q 1985 from the quarterly average of $226.6 billion in 1984.

Trading profits jumped 24% and represented 37% of the increase in proximate non-interest revenues. Profits from market making OTC soared by 63% as OTC prices rose substantially. The NASDAQ Composite Index averaged 280.7 in the 1Q 1985, compared with the 1984 average of 246.9. Trading profits on debt securities increased 18% and were responsible for 21% of the rise in proximate non-interest revenues as interest rates on government bonds declined early in the 1Q 1985 before rising in the latter half of the quarter.

Underwriting revenues increased 3% in the 1Q 1985 as revenues from equities soared by 99% while revenues from debt declined by 6%. Common stock underwriting volume climbed by 90% in the 1Q 1985, but decreases occurred in both corporate debt volume (9%) and municipal volume (15%).14/

Mutual fund sales revenues soared 72% in the 1Q 1985 from the 1984 level. They accounted for 11% of the rise in proximate non-interest revenues. First-quarter sales of mutual funds other than short-term funds were a record $20.0 billion and consisted of $18.4 billion of new sales and $1.6 billion of reinvested dividends.15/ Sales of equity funds amounted to $6.5 billion; combination equity and bond funds, $6.9 billion; corporate bond funds, $1.6 billion; municipal bond funds, $4.0 billion; and option funds, $1.0 billion.

Net margin interest income appears to have also risen because of the increased interest in equities. Customer average margin debit balances rose 23%, to $27.7 billion in 1Q 1985 from the $22.6 billion average in 1984, and average free credit balances increased 15%, to $17.8 billion in 1Q 1985 from the $15.5 billion average in 1984.

14/ Sources: Dealers' Digest and The Bond Buyer

15/ Source: Investment Company Institute

Other-related revenues increased by 11% in the 1Q 1985, compared with a 43% climb in 1984. The average overnight repo rate decreased from 10.1% in 1984 to 8.4% in the 1Q 1985, while the average amount of reverse repos rose 19%, from $86.9 billion in 1984 to $103.5 billion in the 1Q 1985.[16]

Expenses

Increased attention was apparently paid to controlling costs as non-interest expenses rose only 11%. At least 50% of the 1Q 1985 increase in non-interest expenses resulted from the improvement in agency business. For example, RR compensation rose 18% and accounted for 42% of the rise in non-interest expenses.

Total employment expenses rose by 13% overall, however, so-called fixed expenses increased by only 7%. The rate of increase in communications (5%) and occupancy and equipment (14%) costs slowed significantly while expenditures on EDP equipment fell (8%).

Conclusion

Industry profitability in 1984 was abnormally low and at its lowest level since 1977. Although it will be difficult to duplicate the unprecedented profitability the industry enjoyed for 1979 to 1983, factors are in place for ROE to rise appreciably in 1985. Cost containment programs have been instituted and interest rates have fallen. This improvement was already evident in the 1Q 1985 as the industry's annualized after-tax ROE rose to 16%, compared with 7% in 1984. In addition, profits will be less concentrated among the firm categories in 1985 than 1984 because of the pickup in retail business and rise in equity prices.

---

[16] Data on 1Q 1985 M&A fees and private placement fees are not yet available.

Ira Epstein
Assistant Director
of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	April 1985	YEAR-TO-DATE 1985	April 1985	YEAR-TO-DATE 1985	% CHG. Y-T-D 1985 - 1984
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	94.4	108.5	85.9	93.1	16.5%
AMEX (MILS.)*	7.8	9.0	5.9	6.2	45.2
NASDAQ (MILS.)*	71.7	80.3	57.4	60.3	33.2
REGIONAL EXCHANGE (MILS.)*	15.6	18.8	13.9	14.1	33.3
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	69,670	311,857	56,351	265,354	17.5
AMEX (MILS.)					
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,201	27,576	6,900	29,290	(5.9)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,311	64,821	13,376	54,751	18.4
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	51.7	51.2	49.6	49.3	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	10,059	47,295	8,793	37,868	24.9
AMEX OPTIONS	2,342	11,473	2,644	12,617	(9.1)
COMMODITY	12,337	52,004	11,652	49,249	5.6

* *MONTHLY AVERAGE*

YIELDS
(MONTHLY AVERAGES)

	April 1985	April 1984	Basis Point Change April 85-April 84
BOND BUYER INDEX (20 BOND)	9.41	9.96	(55)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.23	12.81	(58)
Baa CORPORATE	13.51	14.31	(80)
RATIO Aaa CORPORATES TO Baa CORPORATES	.91	.90	1
MUNICIPAL BOND YIELD (MOODY'S)	9.42	9.54	(12)

PRICES
(END OF MONTH)

	April 1985	April 1984	% Change April 85-April 84
DOW JONES INDUSTRIALS	1258.06	1170.75	7.46
STANDARD & POOR'S 500	179.83	160.05	12.36
NYSE COMPOSITE	104.12	91.98	13.20
AMEX MARKET VALUE INDEX	227.44	210.40	8.10
VALUE LINE COMPOSITE	191.58	179.91	6.49
NASDAQ COMPOSITE	280.56	247.44	13.39

UNDERWRITING
(DOLLARS IN MILLIONS)

	April 1985	April 1984	% Change April 1985 - April 84
CORPORATE FINANCING (Gross New Issues)			
Total	11,132	5,975	86.3%
Common Stock	2,096	611	243.0
# of Common Stock Issues	63	48	31.3
Preferred Stock	643	223	188.3
# of Preferred Stock Issues	12	4	200.0
Corporate Debt	8,393	4,757	76.4
# of Corporate Debt Issues	93	43	116.3
MUNICIPAL FINANCING (Gross New Issues)			
Total	13,727	11,293	21.6%
Notes	4,587	6,158	(25.5)
Bonds	9,140	5,135	78.0

MARGIN DEBT

	1985 April	1984 April	% Change Apr.85-Apr. 84
MARGIN DEBT OUTSTANDING ($MILS)	23,900	22,830	4.7
NET CHANGE IN MARGIN DEBT ($MILS)	1,070	7,570	(85.9)
% OF ACCOUNTS WITH EQUITY UNDER 40%	11	12	-----

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	First Quarter 1985	Yr.-To-Date 1985	First Quarter 1984	Yr-To-Date 1984	% Change 4th Q.1985 4th Q.1984	Yr.-To-Date % Change 1985 - 1984
REVENUE						
SECURITIES COMMISSION INCOME	$2,167	$2,167	$1,972	$1,972	9.9%	9.9%
TRADING PROFITS	2,345	2,345	1,947	1,947	20.4	20.4
UNDERWRITING	700	700	553	553	26.6	26.6
TOTAL REVENUE	8,970	8,970	7,944	7,944	12.9	12.9
TOTAL EXPENSES	8,037	8,037	6,947	6,947	15.7	15.7
NET INCOME BEFORE TAXES	933	933	497	3,497	87.7	87.7
PERCENT OF FIRMS SHOWING LOSS	17.1%	17.1%	31.3%	31.3%	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
The New York Securities Industry: Its Contribution To New York State and City	This recent study, conducted by Professor Allan Young of Syracuse University, concludes that the New York securities industry has a significant impact on the State and City economies. For instance, the study finds that the industry contributes directly and indirectly almost 10% of all taxes collected by the City and State. Additionally, one in six private sector jobs was created by the securities industry.	Orders being taken by SIA $20 Members, $35 Others
Comparison of Individual Taxation of Capital Gains on Portfolio Stock Investment in Seventeen Countries	SIA/Arthur Andersen study summarizes and discusses major differences in tax treatment of capital gains. Despite major changes, the U.S. tax treatment of capital gains is still generally harsher than that of other countries. Quick reference tables comparing tax rates and holding period in eleven major industrial countries and Pacific Basin.	Publications Department SIA $10 per copy
Securities Industry 1985-86	Sixth annual edition of vital statistics on over 500 SIA member firms and industry. This 640-page hardcover book includes: rankings of firms, directory of members and industry and market data.	Yearbook Department SIA $50 Members $85 Others
1984 NASDAQ FACT BOOK	Statistical review of NASDAQ activity in 1984. Tables include NASDAQ monthly closing index values and average daily sharevolume. Fact Book includes a special section on the performance of NASDAQ securities.	NASD 1735 K Street, N.W. Washington, D.C. 20006
1984 NYSE FACT BOOK	Statistical review of 1984. Tables include market activity data and stock price trends. Fact Book includes historical data from 1970 to 1983, and where available, information prior to that.	New York Stock Exchange, Inc. Eleven Wall Street New York, N.Y. 10005
The Fortune 500	Fortune's annual listing of the 500 largest industrial corporations. Among these corporations, sales increased 4.3% as compared to the prior year, just about even with inflation. Statistical information includes data on sales and assets earning per share.	Fortune 4/29/85

President Reagan's Tax Proposals to the Congress for fairness, growth and simplicity	The President's proposal for reform of the current tax code are detailed in this proposal. Would overhaul current fourteen brackets into three brackets and reduce capital gains to 17.5%. Also proposed are the elimination or curtailment of 65 categories of preferential tax treatment.	BNA Customer Service Center 945 Key West Ave. Rockville, Md. 20850 $35 per copy
The State of Small Business A Report to the President	Comprehensive report on the state of small business in the United States. A detailed statistical section on trends in small business employment is included. Additionally, information is given on the deregulation of small business, small business financing, and women and minority owned businesses.	Superintendent of Documents U.S. Government Printing Office Washington, D.C. 20402
"The Worlds Best Stockbrokers"	A look at the top stock analysts and brokerage firms in the worlds ten largest stockmarkets. The four U.S. brokerage houses selected are Goldman, Sachs, Morgan Stanley, Salomon Brothers and Paine Webber. If you want to know who the top analysts were, read this article. Also included is Euromoney's corporate list of international equities.	Euromoney May 1985
"The Troubled Market in Federal Securities"	The recent failures of ESM Government Securities and Bevill, Bresler & Schulman led to discussion and Congressional hearing on regulation of government securities dealers. While the author makes clear that the government securities market is in need of greater attention, he warns against burdensome regulation which could make things worse.	Fortune 5/13/85

Securities Industry Trends

ANNUAL SUBSCRIPTION
$36.00 member • $60.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

[illegible]

Vol. XI, No. 5 July 31, 1985

Special Issue:

Introducing
SIA's Investor Activity Report

Highlights

1. Based on information which recently became available, SIA is starting a new data series covering retail and institutional trading volume on the NYSE and Amex. The new data series will also contain figures about institutional activity on NASDAQ and the value of institutional trading in the corporate bond secondary market.

2. SIA's data series sheds new light on the size of the institutional and retail markets. In the past, the retail component has been seriously understated due to the use of rough proxies for retail participation.

3. Data for May-June of 1985 show retail share volume accounted for 28% of NYSE volume. For the same period, professional institutional trading accounted for 46% of NYSE share volume and member firm trading, about 25%.

4. As expected, retail activity accounted for an even higher level of activity on the Amex while professional institutional and member firm trading played relatively smaller roles. For May-June 1985, retail participation accounted for about half the Amex volume. Institutions were responsible for about 30% of Amex share volume and member firm principal activity, just under 20%.

5. The relatively high retail figures are somewhat surprising to industry observers. However, the methodology employed in SIA's new statistical series on investor activity is sound and differs substantially from past data collection efforts by the exchanges and others. Moreover, using average order size as a reflection of retail vs. institutional participation in the securities marketplaces is simply too inaccurate given increases in average order size over time by both retail and institutional customers.

Introduction

To what extent does the public participate in the stock market? Despite the widespread publicity of daily share volume on the nation's stock markets, reliable data on the trading patterns of individuals and institutions has been difficult to come by, at best. Based on information which became available only this Spring, the Securities Industry Association is inaugurating a new data series covering the retail and institutional components of trading volume on the New York and American Stock Exchanges. In addition, SIA will be able to trace institutional NASDAQ volume, as well as the value of professional institutional trading activity in corporate bonds. Because there is no equivalent of a tape in the fixed income markets and trading in corporate debt is a highly institutionalized market, this last statistic may be more than adequate in indicating the value of daily trading activity in the corporate bond market by public investors (institutions and individuals).

SIA's institutional/retail breakdown has important implications. First, it indicates the sources of trading volume. Such information is important for securities firms in estimating their market share of retail and/or institutional business. Second, it sheds light on a major area of confusion, namely the size of the institutional market. Much has been written in recent years about the institutionalization of the marketplace; that is, the growing relative importance of trading by pension funds, mutual funds and other fiduciaries. Nevertheless, it appears that the retail component of trading activity has been seriously understated because of the arbitrary proxies commentators have been forced to use in estimating the retail/institutional breakdown.

Knowledge of the true size of the retail and smaller corporate components of trading has important implications for the health of the equities markets and the diversity of decision making in the marketplace. Indeed, public policies aimed at encouraging or discouraging individual participation through tax or other changes affecting investment decisions may take on new significance with a more accurate indicator of the relative importance of trading activity by small and large individual investors.

Past Attempts

The Public Transaction Study

In the past, the closest approximation of the institutional/retail mix has come from periodic statistical samplings of trades at NYSE member organizations, or by using data on reported trades by order size as rough proxies for institutional versus retail activity.

Sporadic estimates of institutional and retail share volume were provided through the Public Transaction Study (PTS) conducted by the New York Stock Exchange. The PTS was done frequently during the controversy over fixed commission rates. However, since the unfixing of rates on May 1, 1975, only two Public Transaction Studies were completed. The most recent PTS was for the fourth quarter of 1980.

Statistical sampling was employed to provide the PTS estimates. All NYSE member firms doing a public business participated, and firm data were collected for from one to five trading days before being expanded to represent aggregate share volume for the fourth quarter of 1980 for the entire NYSE member firm community. Share volume included all agency trades executed by NYSE member organizations on U.S. stock exchanges and in the OTC market. It is likely that accounts which could not be clearly identified by member firms as retail became tabulated as institutional for PTS purposes. For this and other reasons, the sampling technique used probably underreported retail participation.

The results of the last PTS covering the fourth quarter of 1980 were:

	Proportion of Publicly Traded Share Volume		Proportion of Total Share Volume		
	Institutional	Retail	Institutional	Retail	Member Firm Trading
NYSE	65.0%	35.0%	47.5%	25.6%	25.8%
Other Markets	32.4%	67.6%	NA	NA	NA

In other words, during the fourth quarter of 1980, it was estimated that slightly more than one-third of the NYSE share volume traded by the public was conducted by individual investors, and the other two-thirds transacted by institutional investors. Of total NYSE share volume, institutions accounted for slightly less than one-half, with the remainder split almost equally between individual investors and members trading for their own accounts. The member trading figures included activities on the floor as well as trading by upstairs members in such activities as block trading, arbitrage, etc. In other markets, institutions were less dominant, accounting for about one-third of the total public activity, with individuals responsible for roughly two-thirds. Because of the lack of data on member trading in other marketplaces, it was not possible to provide a more refined breakdown of activity in these markets.

There were Public Transaction Studies preceding the fourth quarter of 1980. Table 1 below shows the percentage of public activity split between retail and institutional share volume and the distribution of total share activity on the NYSE by retail, institutional, and member firm trading. The data included start with full-year 1969, and even earlier figures are available.[1/] Prior to 1969, the sampling process used for the PTS was to select one trading day in a particular month and have member firms report all transactions for that day by customer type. However, many observers believe that trading patterns for one day are too small to draw meaningful conclusions from.

Table 1

	Proportion of NYSE Publicly Traded Share Volume		Proportion of NYSE Total Share Volume		
	Institutional	Retail	Institutional	Retail	Member Firm Trading
4Q 1980	64.9%	35.1%	47.4%	25.7%	26.9%
1Q 1976	57.3	42.7	44.5	33.2	22.3
1Q 1974	58.9	41.1	44.6	31.1	24.3
1H 1971	59.7	40.3	45.7	30.8	23.5
FY 1969	55.9	44.1	42.4	33.4	24.2

Source: NYSE, Public Transaction Study, Fourth Quarter 1980

It is clear from the Public Transaction Studies done in the past that there was an increase in the institutionalization of the marketplace from 1969-1980. Excluding member firm trading, institutions increased their share of public volume from 56% in 1969 to almost two-thirds by the fourth quarter of 1980. Correspondingly, individual participation plunged from 44% in 1969 to 35% ten years later.

[1/] See NYSE, Public Transaction Study, Fourth Quarter 1980, pp. 5 and 11.

Including member firm trading, which has gradually risen in relative importance over time, the increase in the relative importance of institutions is considerably less dramatic, growing from 42% in 1969 to 47% by 1980. Meanwhile, individual participation on the NYSE shrunk from one-third of total volume in 1969 to slightly more than one-fourth of the total shares traded during the fourth quarter of 1980.

Average Order Size

Since the fourth quarter of 1980, there have been no formal or comprehensive industry studies estimating the institutional and retail proportion of publicly traded share volume or total share volume (public trading plus member firm principal activities). However, estimates have been published based on reported trade size. For example, one proxy used as an indicator of retail participation is volume in transactions of 900 shares or less.

Table 2

Orders of 100-900 Shares
as a % of Total NYSE Trading Volume

1984	11.3%
1983	14.6
1982	16.2
1981	21.1
1980	24.7
1979	27.5
1978	30.2

Source: NYSE, Fact Book, various issues.

As seen in Table 2, orders under 900 shares have fallen sharply in relative importance. Whereas they accounted for 30% of NYSE share volume in 1978, this percentage dropped to just over 11% by 1984. With the average trade size more than tripling from 559 shares in 1976 to 1,781 shares in 1984, the drop in importance of orders under 900 shares is hardly surprising.

The wisdom of using orders of 900 shares or less as estimates of retail participation is questionable for several reasons. For one thing, individual transactions often occur in trades exceeding 900 shares. Indeed, data collected in the fourth-quarter 1980 PTS showed that only 49% of individual volume on the NYSE was included in trades of 900 shares or less while 51% was in trades exceeding 900 shares. Furthermore, nearly 11% of institutional volume was in trades of 900 shares or less. Moreover, current discussions with several large securities firms indicate that a significant proportion of their retail volume includes trades over 900 shares. Consequently, estimates of NYSE retail share volume based solely on trades of 900 shares or less are inappropriate and sharply understate retail share volume. As average share order size increases by all customers, transactions in 900 shares or less become a poorer and poorer indicator of retail activity.

One of the major indicators of trading volume cited frequently to emphasize the increased institutionalization of the marketplace is blocks of 10,000 shares and over. As shown in Table 3, such blocks have increased dramatically in relative importance.

Table 3

Blocks of 10,000 Shares and Over as a % of NYSE Volume

1984	49.8%
1983	45.6
1982	41.0
1981	31.8
1980	29.2
1979	26.5
1978	22.9

Source: NYSE, Fact Book 1985, p. 71

More recently, such trades accounted for over 50% of the volume on the NYSE. Blocks of 10,000 shares and over have been steadily growing in relative importance on the Exchange. However, there is a great deal of confusion over what this percentage includes. For example, such blocks include member firms trading for their own account. Consequently, blocks of 10,000 shares and over cannot be interpreted as reflecting purely increased institutionalization of the marketplace since a large share of member firm trading is included in such blocks. Indeed, some observers have estimated that member firms as principals are responsible for 30%-40% of trading in blocks of 10,000 shares and over on the NYSE. Finally, there are instances where individual investors and small businesses account for blocks of 10,000 shares and over.

All of the above is not meant only as criticism in using average order size to estimate the relative institutional and individual trading shares in recent years. Rather, we are trying to indicate the dangers and pitfalls in solely using average order size to reflect institutional and individual participation in the securities marketplaces, particularly now with a better reporting mechanism in place.

Current Developments

SIA's Firm and Industry Analysis Committee (FIAC), chaired by Frederick J. Wilten of Prudential-Bache Securities Inc., initiated a project to obtain accurate and comprehensive institutional and retail share volume data by marketplace. SIA funded this project because of its importance and interest to the industry and to observers of the securities markets.

The FIAC initiated project included by year-end 1984 a comprehensive universe of reporting broker-dealers (1,528) and participating institutions (4,377). The data are processed and aggregated by the Depository Trust Company with the cooperation of other depositories for SIA's use. The Association's Research Department compiles and analyzes the data in generating reports to describe trends in trading activity.

Share volume is reported for all deliver-versus-payment (DVP) transactions and receive-versus-payment (RVP) transactions, which includes almost all institutional volume.2/ The data cover each trading day and are reported

---

2/ There are some instances where some institutional transactions may not be included. Also, there are some individual transactions which may be included. The share volume of these exceptions is not considered significant to alter our general trends and conclusions.

Instances where institutional share volume may not be reported are: (1) transactions settled outside the U.S.; (2) the institutional customer and its agent are not participants in any securities depository; and (3) transactions of small institutions whose agents are NYSE members and whose securities are in "street" name.

Instances where individual share volume may be included: (1) an NYSE member acts as the agent for a group of individuals; and (2) individuals whose accounts are large enough to qualify as bank custody accounts.

weekly to SIA on a preliminary basis with a one week lag. Final data for a particular month are reporting at the beginning of the following month.

This new data base starts with May 1, 1985. The summary results for the NYSE in May and June 1985 are:

	Proportion of NYSE Publicly Traded Share Volume		Proportion of NYSE Total Share Volume		
	Professional Institution	Retail	Professional Institution	Retail	Member Firm Trading
May	62.3%	37.7%	46.5%	28.1%	25.3%
June	62.2	37.8	46.0	28.0	26.1

The retail sector's proportion of NYSE share volume is significantly higher than estimates based on proxies such as trades of 900 shares or less. This conclusion should come as no surprise since both fourth quarter 1980 PTS data and current individual firm data reveal that a large proportion of retail share volume occurs in trades exceeding 900 shares.

Of the total volume on the NYSE, retail activity accounted for about 28% in May and June. The remaining 72% is attributed to professional institutional activity and members trading as principals. Member trading information is filed with the NYSE on Form 121, which requires that any round-lot purchase or sale of stock effected on the floor of the New York Stock Exchange for members, allied members, or member organizations be reported regardless of where the order originated or by whom it was executed. The Amex has an identical reporting requirement. If member trading were excluded from the figures, the percentage of public trading divided between institutions and retail was 62%-38% in both May and June.

On the Amex, as expected, retail activity is an even higher proportion of total volume. In fact, retail activity accounted for about half the total volume on the Amex during May and June. Professional institutional activity, on the other hand, accounted for about 30% of Amex total share volume. Like institutional activity, member trading also accounted for a smaller proportion of Amex volume relative to NYSE activity. The table below shows the relevant data for the Amex.

	Proportion of Amex Publicly Traded Share Volume		Proportion of Amex Total Share Volume		
	Professional Institution	Retail	Professional Institution	Retail	Member Firm Trading
May	35.1%	64.9%	28.4%	52.5%	19.1%
June	40.5	59.5	33.1	48.6	19.0

Data Differences

The high percentage of retail activity on the NYSE may be the most surprising conclusion from this new data base. We suspect that estimates used in the past may have always understated the relative importance of retail business, given the rough proxies used. For example, in the PTS, all activity generated by non-member firms was classified as institutional, even if the bulk of that activity were for retail clients. Furthermore, several changes have taken place in recent years that may have increased activity by retail clients. For one thing, there has been a sharp increase in the growth of self-directed IRAs, Keoghs, and 401(k) plans. Self-directed IRAs of broker-dealers have grown substantially and, according to one source, amounted to $25.2 billion as of April 30, 1985.[3] Needless to say, lower capital gains tax rates encourage individual investor trading as does the reduced holding period to qualify for long-term gains.

The May-June 1985 institutional and retail proportions of public and total share volume are quite similar to those obtained for the fourth-quarter 1980 PTS. However, the results from SIA's Investor Activity Report (SIAR) and the PTS are not strictly comparable. Differences exist in the comprehensiveness of the data, the collection method and in the definitions of individual and institutional customers. We believe, frankly, that the process used today by the depositories in obtaining figures for professional institutional activity (the Institutional Delivery System) is, by far, more accurate than past attempts or present alternatives.

---

[3] Growth of self-directed IRAs at broker-dealers: December 1982, $4.4 billion; April 30, 1983, $9.3 billion; April 30, 1984, $16.4 billion; and April 30, 1985, $25.2 billion. Source: "IRA Reporter"

In effect, in the past Public Transaction Studies, any trade not coded as retail by member firms was automatically classified as institutional. Thus, retail trades were probably underreported with institutional trades overreported. There is confidence about the accuracy in reporting member firm trading because of Exchange requirements. The member firm trading figures have been available for many years now and have never, to our knowledge, been questioned.

Our current procedure for obtaining institutional activity may slightly overemphasize retail while understating institutional activity. If an institutional transaction is not captured in the Institutional Delivery System, it will be classified as retail using our methodology. The retail trading figures are estimated after institutional activity and member firm trading are subtracted from the aggregate trading figures. There may be some trades by small institutions which are not caught in the Institutional Delivery System. After discussions with various firms, we are confident that any distortions cannot exceed more than a few percentage points. Thus, as knowledge about our methodology and numbers increase, we fully expect greater confidence and acceptance by the securities community.

Future Reports

SIA's Research Department will publish two reports using the new data base. A periodic weekly report will be produced analyzing market events of note and including NYSE and Amex institutional and retail share volume data. For example, this "flash" report may focus on investor behavior during a particularly active trading week.

A detailed monthly report will also analyze activity and contain the following statistics:

(1) NYSE and Amex institutional and retail share volume and their share of publicly traded and total share volume on a daily basis. Member firm trading will also be included in these reports.

(2) Daily indexes of NYSE and Amex institutional and retail share volume.

(3) Institutional share volume on NASDAQ on a daily basis.

(4) The value of institutional trades in corporate debt on a daily basis. This information has never been available before, to the best of our knowledge.

A copy of the NYSE and Amex monthly data for May is attached.

The periodic weekly and 12 monthly reports are available on a subscription basis only. For your convenience, a subscription form is enclosed.

In addition, SIA plans to establish a subscription service whereby participating firms will be able to measure their penetration of the retail and institutional markets. On a confidential basis, reports will be generated, using the new data base and figures supplied by the firm, showing the firm's share of institutional activity by marketplace and institutional trades in corporate debt. This service will be initiated when a sufficient base of participating firms is established. For more information, contact the author.

Jeffrey M. Schaefer
Senior Vice President and
Director of Research

SIA INVESTOR ACTIVITY REPORT

						NYSE SHARES PUBLICLY TRADED				ACTIVITY INDEX (INDEXED TO MAY 1, 1985)		% OF TOTAL NYSE SHARE VOLUME		
		(SALES) NYSE TOTAL SHARE VOLUME	NYSE SALES AND PURCHASES	MEMBER TRADING	NYSE SHARES PUBLICLY TRADED	PROFESSIONAL INSTITUTION ACTIVITY	PROFESSIONAL INSTITUTION %	RETAIL ACTIVITY	RETAIL %	PROFESSIONAL INSTITUTION	RETAIL	PROFESSIONAL INSTITUTION	RETAIL	MEMBER TRADING
MAY	1	101,752,070	203,504,140	49,570,865	153,933,275	100,504,594	65.3%	53,428,681	34.7%	100.0	100.0	49.4%	26.3%	24.4%
***	2	107,689,120	215,378,240	51,723,228	163,655,012	109,064,665	66.6%	54,590,347	33.4%	108.5	102.2	50.6%	25.3%	24.0%
	3	95,096,000	190,192,000	47,740,757	142,451,243	88,533,482	62.2%	53,917,761	37.8%	88.1	100.9	46.5%	28.3%	25.1%
	4		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	5		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	6	85,871,800	171,743,600	42,247,488	129,496,112	75,932,429	58.6%	53,563,683	41.4%	75.6	100.3	44.2%	31.2%	24.6%
	7	100,503,900	201,007,800	50,330,224	150,677,576	90,897,175	60.3%	59,780,401	39.7%	90.4	111.9	45.2%	29.7%	25.0%
	8	101,468,490	202,936,980	50,899,745	152,037,235	103,084,708	67.8%	48,952,527	32.2%	102.6	91.6	50.8%	24.1%	25.1%
	9	111,259,130	222,518,260	53,639,915	168,878,345	107,993,520	63.9%	60,984,825	36.1%	107.5	114.1	48.5%	27.4%	24.1%
	10	140,539,750	281,079,500	77,072,181	204,007,319	127,359,009	62.4%	76,648,310	37.6%	126.7	143.5	45.3%	27.3%	27.4%
	11		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	12		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	13	86,195,260	172,390,520	44,513,540	127,876,980	75,540,980	59.1%	52,336,000	40.9%	75.2	98.0	43.8%	30.4%	25.8%
	14	97,628,160	195,256,320	49,611,039	145,645,281	89,309,738	61.3%	56,335,543	38.7%	88.9	105.4	45.7%	28.9%	25.4%
	15	106,368,850	212,737,700	56,184,570	156,553,130	101,864,813	65.1%	54,688,317	34.9%	101.4	102.4	47.9%	25.7%	26.4%
	16	99,760,850	199,521,700	51,162,763	148,358,937	92,490,484	62.3%	55,868,453	37.7%	92.0	104.6	46.4%	28.0%	25.6%
	17	124,978,867	249,957,734	60,780,444	189,177,290	119,008,814	62.9%	70,168,476	37.1%	118.4	131.3	47.6%	28.1%	24.3%
	18		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	19		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	20**		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	21	130,462,770	260,925,540	65,215,964	195,709,576	119,533,546	61.1%	76,176,030	38.9%	118.9	142.6	45.8%	29.2%	25.0%
	22	101,592,350	203,184,700	53,333,888	149,850,812	89,964,870	60.0%	59,885,942	40.0%	89.5	112.1	44.3%	29.5%	26.2%
	23	101,193,720	202,387,440	53,014,896	149,372,544	89,527,218	59.9%	59,845,326	40.1%	89.1	112.0	44.2%	29.6%	26.2%
	24	86,371,220	172,742,440	46,710,066	126,032,374	77,355,436	61.4%	48,676,938	38.6%	77.0	91.1	44.8%	28.2%	27.0%
	25		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	26		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	27		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	28	90,967,130	181,934,260	45,162,985	136,771,275	76,670,755	56.1%	60,100,520	43.9%	76.3	112.5	42.1%	33.0%	24.8%
	29	96,823,630	193,647,260	48,458,078	145,189,182	90,682,431	62.5%	54,506,751	37.5%	90.2	102.0	46.8%	28.1%	25.0%
	30	108,647,220	217,294,440	55,642,622	161,651,818	104,152,059	64.4%	57,499,559	35.6%	103.6	107.6	47.9%	26.5%	25.6%
	31	134,458,720	268,917,440	66,530,403	202,387,037	126,301,794	62.4%	76,085,243	37.6%	125.7	142.4	47.0%	28.3%	24.7%
DAILY AVERAGE (Mils.)		105.2	210.4	53.3	157.1	97.9	62.3%	59.2	37.7%	--	--	46.5%	28.1%	25.3%

*Zero indicates market was closed

Copyright 1995 Securities Industry Association, Inc.

SIA INVESTOR ACTIVITY REPORT

						--AMEX SHARES-- PUBLICLY TRADED				--ACTIVITY-- INDEX (INDEXED TO MAY 1, 1985)		--% OF TOTAL AMEX-- SHARE VOLUME		
		(SALES) AMEX TOTAL SHARE VOLUME	AMEX SALES AND PURCHASES	MEMBER TRADING	AMEX SHARES PUBLICLY TRADED	PROFESSIONAL INSTITUTION ACTIVITY	PROFESSIONAL INSTITUTION %	RETAIL ACTIVITY	RETAIL %	PROFESSIONAL INSTITUTION	RETAIL	PROFESSIONAL INSTITUTION	RETAIL	MEMBER TRADING
MAY	1	8.687.500	17.375.000	4,091.153	13.283.847	6.554.778	49.3%	6.729.069	50.7%	100.0	100.0	37.7%	38.7%	23.5%
***	2	6.873.400	13.746.800	2,743.460	11.003.340	4,443.073	40.4%	6.560.267	59.6%	67.8	97.5	32.3%	47.7%	20.0%
	3	5.600.710	11.201.420	2.038.626	9.162.794	2.952.921	32.2%	6,209.373	67.8%	45.0	92.3	26.4%	55.4%	18.2%
	4		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	5		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	6	6.317.055	12,634,110	2.317.190	10.316.920	3,284.381	31.8%	7.032.539	68.2%	50.1	104.5	26.0%	55.7%	18.3%
	7	6,986,805	13.973.610	3.014,865	10,958,745	3.495.063	31.9%	7,463.682	68.1%	53.3	110.9	25.0%	53.4%	21.6%
	8	6,996,110	13,992.220	2,966,868	11,025.352	4.023.442	36.5%	7.001,910	63.5%	61.4	104.1	28.8%	50.0%	21.2%
	9	6,922,445	13,844.890	3,945,093	9.899.797	3,286.207	33.2%	6.613.590	66.8%	50.1	98.3	23.7%	47.8%	28.5%
	10	9,410.440	18.820.880	2,366,102	16.454,778	6.563.201	39.9%	9.891.577	60.1%	100.1	147.0	34.9%	52.6%	12.6%
	11		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	12		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	13	6.042.260	12,084.520	2.366.102	9.718.419	2.819.239	29.0%	6,899.179	71.0%	43.0	102.5	23.3%	57.1%	19.6%
	14	7.029,455	14,058.910	2,529,794	11.529.116	4,075.771	35.4%	7,453.345	64.6%	62.2	110.8	29.0%	53.0%	18.0%
	15	7,440.740	14.881.480	2.855.162	12,026.318	3.457.682	28.8%	8.568.636	71.2%	52.8	127.3	23.2%	57.6%	19.2%
	16	6.486.380	12,972.760	2,561.811	10.410,949	3,550.640	34.1%	6.860.309	65.9%	54.2	102.0	27.4%	52.9%	19.7%
	17	6.940.740	13.881.480	2,683.435	11.198.045	4,060.799	36.3%	7.137.246	63.7%	62.0	106.1	29.3%	51.4%	19.3%
	18		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	19		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	20	9.051.315	18.102.630	2.847.176	15.255.454	5.381.653	35.3%	9.873.801	64.7%	82.1	146.7	29.7%	54.5%	15.7%
	21	7,546,090	15.092.180	2.925.898	12.166.282	3,909.678	32.1%	8,256.604	67.9%	59.6	122.7	25.9%	54.7%	19.4%
	22	7.401.525	14.803.050	2.403.860	12.399.190	3.796.439	30.6%	8.602.751	69.4%	57.9	127.8	25.6%	58.1%	16.2%
	23	7.901.855	15.803.710	2,777,315	13.026.395	3.994.949	30.7%	9.031.446	69.3%	60.9	134.2	25.3%	57.1%	17.6%
	24	5.393.165	10.786.330	2.296.955	8.489.375	3.169.151	37.3%	5,320.224	62.7%	48.3	79.1	29.4%	49.3%	21.3%
	25		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	26		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	27		0		0		0.0%	0	0.0%	.0	.0	0.0%	0.0%	0.0%
	28	6.435.590	12,871.180	2.692.451	10.178.729	3.994.814	39.2%	6.183.915	60.8%	60.9	91.9	31.0%	48.0%	20.9%
	29	5.466.245	10.932.490	2,264.900	8.667.590	2,567.513	29.6%	6.100.077	70.4%	39.2	90.7	23.5%	55.8%	20.7%
	30	6.759,900	13,519.600	2.953.170	10.566.630	3.816.963	36.1%	6.749.667	63.9%	58.2	100.3	26.2%	49.9%	21.8%
	31	7.264.450	14,528.900	2.506.820	12.022.080	4.181.914	34.8%	7.840.166	65.2%	63.8	116.5	28.9%	54.0%	17.3%
DAILY AVERAGE (Mils.)		7.0	14.1	2.7	11.4	4.0	35.1%	7.4	64.9%	--	--	28.4%	52.5%	19.1%

*Zero indicates market was closed

Copyright 1985 Securities Industry Association, Inc.

Securities Industry Trends

ANNUAL SUBSCRIPTION
$36.00 member • $60.00 non-member

AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

K25 A8825-1

Vol. XI, No. 6 August 26, 1985

A Summary of The New York Securities Industry: Its Contribution To New York State And City

Highlights

1. By 1983, including jobs created in related industries, the New York based securities industry accounted for one in six of all private sector jobs in the City.
2. At the end of 1983, the New York based securities industry accounted for $7.5 billion in borrowing from New York City banks, 6.6% of all the lending activity of these institutions.
3. At the end of 1983, the New York based securities industry leased 24.2 million square feet of office space or 8.1% of all the rented office space in Manhattan.
4. Employee compensation, at both the clerical and professional levels, is consistently higher in New York than in the remainder of the country, as are expenses per employee.
5. The New York based securities industry, including linkage effects, contributed from $60-$68 billion to the economy of the region in 1983.
6. Total City and State taxes paid by the industry in 1983 were between $570-$587 million and, including linkage effects, contributed about $2.4 billion or about 9.9% of all taxes collected at the City and State levels.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 608-1500

Introduction

This issue of Securities Industry Trends will summarize the recently completed study, The New York Securities Industry: Its Contribution to New York State and City. The full study was commissioned by SIA's New York District and prepared by Professor Allan Young, Syracuse University, along with Jeff Schaefer and David Strongin of SIA's Research Department. The purpose of the study was to measure the contribution of the New York based securities industry to the economy of New York State and City.

Due to the study's length, this issue of Trends will only cover data on the contribution of the securities industry to New York City and State employment, tax revenues, office space, and New York's role as a financial center. Copies of the full report can be acquired by completing an order form, which is included in your package.

Methodology

For the most part, the data collected for this study were obtained from questionnaires sent to a sample of New York District Securities Industry Association member firms and a series of interviews with industry leaders. These data and the projections based upon them were checked for reasonableness against a series of published and unpublished sources (principally, aggregated FOCUS Reports). The questionnaire was completed by 74 firms, most of whom are among the largest firms in the industry. In many instances, the questionnaire results were used to project figures representative of the entire New York based securities industry.1/

Employment Data

Employment statistics for the securities industry from 1973 to 1983 show an increase in New York State and City. During recent years, employment growth for the industry has been particularly strong in both the State and City (Table 1). However, there was a slight decline in the proportion of New York State industry personnel working in New York City.

1/Projections, or the expansion factors, were based upon the relationship between the New York employment figures for responding firms in our survey and the U.S. Department of Labor benchmark figures for New York securities industry employment. For U.S. Department of Labor purposes, the securities industry is a sub-category of "financial services."

Table 1

Securities Industry Personnel (in thousands):
Security and Commodity Brokers and Services

	N.Y. State	Change From Prior Year (N.Y. State)	N.Y. City	Change From Prior Year (N.Y. City)	N.Y. City as % of N.Y. State
Dec. 1973	77.4	-	74.5	-	96.3%
1974	69.0	-10.9%	66.1	-11.3%	95.8
1975	69.4	.6	67.0	1.4	96.5
1976	72.8	4.9	70.1	4.6	96.3
1977	73.3	.7	70.2	.1	95.8
1978	77.0	5.1	73.7	5.0	95.7
1979	82.1	6.6	78.4	6.4	95.5
1980	94.8	15.5	90.0	14.8	94.9
1981	105.0	10.8	99.6	10.7	94.9
1982	108.9	3.7	102.7	3.1	94.3
1983	122.2	12.2	115.0	12.0	94.1

Source: U.S. Department of Labor, Bureau of Labor Statistics and New York State Department of Labor.

In New York City, from 1980 to 1983, employment increased by 25,000 jobs in security and commodity brokerage and allied services. Using a multiplier of 3 to 1 for the securities industry,[2] 75,000 additional jobs may have been created. In other words, the securities industry contributed, directly and indirectly, 100,000 jobs to New York City from 1980 to 1983. This represents more than twice the increase in total private employment in New York City from 1980 to 1983.[3]

The service sector's proportion of total New York City private employment climbed from 19% in 1958 to 34% in 1983 (Table 2). This trend contrasts sharply with the drop in the percentage of manufacturing employment to total private employment. Furthermore, it is clear that securities industry employment is becoming more important within the service sector and in relation to total private employment in New York City.

During 1983, direct employment in the New York City based securities industry was 115,000 and indirect employment, based on the multiplier effect, was 345,000. This accounted for 16% of total private employment in New York City.

---

[2] Multipliers of from 2-1/2 to 1 to 3 to 1 have been used in various studies of the securities industry such as those produced by the NYSE, and the New York City Economic Development Administration. The proximity of most estimates in this study show the contribution of the New York based securities industry to be consistent with estimates produced by these organizations through entirely different computational procedures. However, a somewhat lower multiplier would not alter the general trends in the study nor the nature of the conclusions reached.

[3] Bureau of Labor statistics put total private employment growth from 1980 to 1983 at 48,400.

Table 2

New York City Employment Trends (in thousands)

Year End	Total Private Employment	Manuacturing	Percent of Manufacturing to Total Private Employment	All Services	Percent of All Services to Total Private Employment	Security and Commodity Brokers and Services	Percent of Security and Commodity Brokers and Services to all Services	Percent of Security and Commodity Brokers and Services to Total Private Employment
	(1)	(2)	(2)/(1)	(3)	(3)/(1)	(4)	(4)/(3)	(4)/(1)
1958	3,125.3	955.2	30.6%	585.7	18.7%	42.1	7.2%	1.4%
1965	3,170.9	863.5	27.2	691.2	21.8	57.2	8.3	1.8
1970	3,132.5	730.1	23.3	782.5	25.0	83.2	10.6	2.7
1971	3,029.6	682.9	22.5	775.5	25.6	87.2	11.2	2.9
1972	3,038.8	668.5	22.0	797.1	26.2	87.6	11.0	2.9
1973	2,952.1	631.7	21.4	793.4	26.9	74.5	9.4	2.5
1974	2,813.3	551.8	19.6	785.3	27.9	66.1	8.4	2.4
1975	2,723.9	539.6	19.8	772.8	28.4	67.0	8.7	2.5
1976	2,711.1	532.2	19.6	779.6	28.8	70.1	9.0	2.6
1977	2,723.2	534.4	19.6	803.8	29.5	70.2	8.7	2.6
1978	2,778.4	528.3	19.0	846.7	30.5	73.7	8.7	2.7
1979	2,798.4	504.7	18.0	880.5	31.5	78.4	8.9	2.8
1980	2,837.0	483.5	17.0	924.5	32.5	90.0	9.7	3.2
1981	2,877.1	469.5	16.3	953.8	33.2	99.6	10.4	3.5
1982	2,843.2	430.5	15.1	964.0	33.9	102.7	10.7	3.6
1983	2,885.4	430.8	14.9	987.1	34.2	115.0	11.7	4.0

Source: New York State Department of Labor

Among our responding firms, there was a dramatic increase of 43% in employment from 1980-1983 (Table 3). The employment climb experienced by these responding New York City firms was somewhat greater than the 37% increase for securities firms located throughout the U.S.[4]

Table 3

Increase in Securities
Industry Employment for Responding Firms, 1980-1983

New York Metropolitan Area Employment	1980	1983	Percentage Increase from 1980-1983
30 or less	323	397	22.9%
31 to 100	509	612	20.2
101 to 1,000	7,172	9,459	31.9
1,001 or more	41,386	60,339	45.8
Totals	49,390	70,807	43.3%

The impressive increase during these years reflects, in part, high industry profitability and the introduction of new products, particularly among the largest firms.

Securities Industry Borrowing

The New York based securities industry also has an important impact upon the local economy as a result of its borrowing activities. Data from the responding firms indicated that larger securities firms tend to engage in borrowing more often than smaller organizations. Also, 58 firms who responded positively to the question "Did you borrow funds during 1983 to finance any business activity?", engaged, at least partially, in borrowing from a New York lending institution (Table 4). Furthermore, data from the questionnaire indicated that the smaller firms were more likely to have a larger percentage of their borrowing from New York sources.

---

[4] Source: FOCUS Report

Table 4

New York Metropolitan Area Employment	Did You Borrow Funds During 1983 to Finance Any Business Activity?	
	Yes	No
30 or less*	11	11
31 to 100	10	1
101 to 1,000	22	3
1,001 or more	15	0
Totals	58	15

* One firm in this category did not respond to this question.

Finally, responding firms indicated that 81% or $4.6 billion of their total borrowing was from New York City Metropolitan area sources. By using the appropriate expansion factor, it is estimated that total borrowing by New York City securities firms in the Metropolitan area was $7.5 billion. This represented 6.6% of the $114.0 billion of all outstanding loans of large New York commercial banks as of December 31, 1983.[5]

Occupancy Space of the Securities Industry

In terms of the industry's contribution to New York, industry occupancy data reported on the questionnaires was compared to the total rented office space. As of December 31, 1983, there was 309.9 million square feet of total office space on the market. Presuming a vacancy rate of 3.5%, the amount of office space rented in Manhattan was 299.1 million square feet. Securities firms in New York City leased 24.2 million square feet of office space in 1983. It is estimated that the securities industry accounted for 8.1% of all rented office space in New York City. In addition, total occupancy expense by securities firms was estimated at $406.7 million.

---

[5] Excludes Federal funds.

There is a tendency for occupancy costs per foot to decline as firm size increases (Table 5). This suggests that larger firms may enjoy some economies of scale when it comes to occupancy needs and suggests that larger firms have greater bargaining power with their landlords.

Table 5

Space Occupancy Data for Responding Firms

New York Metropolitan Area Employment	Percentage Increase from 1/1/82 to 12/31/83 for All Firms in Category		Total New York Met. Area Space Occupancy Expense	Space Occupancy Expense Per Square Foot
	In Number of Offices	In Square Feet		
30 or Less	15%	22%	$ 2,097,350	$19.68
31 to 100	60%	12%	1,860,501	18.41
101 to 1,000	19%	47%	27,722,356	18.89
1,001 or More	23%	23%	218,713,210	16.07
Total For All Responding Firms	23%	25%	$250,393,417	$16.38

Securities Industry Revenues and Expenses

Revenues

Prior studies concluded that revenue per employee was greater for smaller firms than larger ones.[6] Larger firms usually have back office employees, which lowers average revenue per employee. However, this study did not uncover any significant inverse relationship between firm size and revenue per employee.

Revenues per employee were also higher than those found in earlier studies. In large part, this reflects the good years the industry had from 1980-1983. Table 5 below also shows the mean revenue per employee to be considerably greater in 1983 than in 1980. Projected revenues for the entire New York City Metropolitan area based industry for 1980 was $14.3 billion compared with $23.4 billion in 1983.

Expenses

Expense data reported by the responding firms underscored the major contribution of the securities industry to New York State and City. Expense data clearly indicated that employee compensation was a major expense. SIA's Report on Human Resources, Management Practices and Employee Benefits, 1984 shows a 121.3% increase in mean weekly clerical salary from 1970-1983. Mean weekly clerical salary outside of New York City was $279 in 1983 compared to $289 within the city.

---

[6] Michael Keenan and Lawrence G. Goldberg, The New York Based Securities Industry - 1979 Survey, occasional papers in Metropolitan Business and Finance, No.2, 1980.

Table 6

Revenue Per Employee: Change From 1980 to 1983

	For firms with 30 or less employees working in the New York Metropolitan Area		For firms with 31 to 100 employees working in the New York Metropolitan Area		For firms with 101 to 1,000 employees working in the New York Metropolitan Area		For firms with 1,001 or more employees working in the New York Metropolitan Area		Total for all responding firms	
	1980	1983	1980	1983	1980	1983	1980	1983	1980	1983
Mean Revenue Per Employee	$ 179,509	$ 392,428	$ 133,822	$ 139,259	$ 166,275	$ 190,333	$ 207,065	$ 228,669	$ 171,908	$ 249,754
Mean (Extreme Cases Removed)	$ 179,509	$ 225,040	$ 133,822	$ 139,259	$ 122,750	$ 173,928	$ 166,277	$ 219,846	$ 145,269	$ 191,640

Analyses of data obtained from SIA's Report on Office Salaries in the Securities Industry - 1983 and Management and Professional Earnings in the Securities Industry show similar trends for professional and managerial positions.
For example:

Table 7

	New York City		Outside of New York City		Percent Difference	
Job Category	Salary	Bonus	Salary	Bonus	Salary	Bonus
Dept. Heads	$39,380	$18,470	$30,155	$12,472	30.6%	48.1%
Operations Dept. Managers	31,069	10,854	25,721	5,891	20.8	84.2
Operations Supervisors	23,087	3,757	18,813	2,469	27.7	52.2

Furthermore, expenses per employee for firm categories generally situated in New York City -- National Full Line, Large Investment Banks and New York City Based Regionals -- are significantly higher than those of Regionals (Table 8).

Mean expenses per employee for the total securities industry for 1983 were $131,108. Multiplying this figure by 1983 New York City employment in the securities industry provides estimated total New York expenses of the securities industry of $15.1 billion. Given the multiplier effect, the total contribution of the securities industry to the New York economy was $60.4 billion in 1983.

The $60.4 billion can be refined further, regional firms have lower expenses per employee than the total industry. A more useful overall estimate of the contribution of the N.Y. based securities industry may be acquired by excluding regionals. Thus, taking the mean for 1983 (excluding regionals), and using the same procedure as above, an estimate of $16.9 billion was obtained for expenses of the N.Y. based securities industry. Given the multiplier effect, $67.6 billion may have been contributed by the securities industry to the N.Y. economy as compared to the $60 billion estimated earlier.

Table 8

Mean of Expenses Per Employee
For Various Type Securities Firms For 1982 and 1983

Time	Total Securities Industry	Top 10	Top 11-25	National Full Line	Large Investment Bank	Small New York Based	Large New York Based	Small Regional	Medium Regional	Large Regional
Mean For 8 Qtrs. of 1982 and 1983	$124,154	$129,367	$118,887	$ 95,826	$280,958	$103,875	$122,629	$ 74,084	$ 86,851	$ 86,610
Mean For 4 Qtrs. of 1982	$117,200	$124,869	$109,590	$ 89,031	$284,858	$ 97,788	$115,693	$ 70,178	$ 81,830	$ 80,519
Mean For 4 Qtrs. of 1983	$131,108	$133,866	$128,184	$102,621	$277,058	$109,961	$129,566	$ 77,991	$ 91,871	$ 92,702
Overall Mean For 1982 Excluding Regionals		$136,972						------		
Overall Mean For 1983 Excluding Regionals		$146,876						------		

Source: The data were developed from FOCUS Reports.

Tax Contribution of The Securities Industry

Tax data from the questionnaires showed taxes of $126 million and $235 million paid to New York City and State, respectively. Using our expansion factors, it is estimated that the securities industry paid New York City taxes of $205 million and New York State taxes of $382 million for a combined total of $587 million paid directly by the securities industry. Applying the multiplier, $2.4 billion in taxes was generated directly and indirectly by the New York based securities industry. Total tax revenues collected by the city and state were $24.3 billion.[7] Thus, the direct and indirect tax contribution of the New York Securities industry accounted for about 9.9% of all combined tax receipts by the City and State.

It is also instructive to look at the impact of the industry on the tax collections of the City and State in relation to the industry's relative size. At the end of 1983, the industry accounted for about 3.4% of the City's total non-agricultural employment (115,000/3,408,000)[8]. In 1983, the securities industry contributed directly and indirectly about 13.9% of New York City's total tax receipts ($1,220 million/$8,757 million). At the State level, at the end of 1983, the securities industry represented 1.7% of total non-agricultural employment (122,200/7,285,300), yet directly and indirectly contributed 6.9% of total tax revenues ($1,062 million/$15,445 million). Clearly, the New York based securities industry plays a role well beyond its immediate size in the tax collections of New York City and New York State.

New York as a Financial Center

As we near the end of our analysis, it is appropriate to discuss the position of New York City in the future securities industry.

Some have said that much of the U.S. securities industry is based in New York City because of inertia. Unlike other U.S. industries (for example, steel), there is not any economic or geographic necessity for the industry to be centered in New York City. At one time, the Port of New York and conditions surrounding its development may have been responsible for the City's growth as a financial center. At the present time, particularly in an era of sophisticated electronic telecommunication devices, the focus of the securities industry in New York may be viewed as little more than an historical accident. If the economics of the industry change and costs and competition increase further in importance, the industry focus could well move elsewhere.

---

[7] Sources of input data: Moody's Municipal and Government Manual, 1984; Employment Review, NYS Dept. of Labor, Division of Research and Statistics, January 1984; and New York State Statistical Abstract, 1983-84.

[8] New York State Department of Labor employment statistics.

The future interplay of costs and competition for New York versus other locations conflict. For while higher costs in New York may favor other locations, most future competitive forces act in New York's favor. On the expense side, New York is at a disadvantage. While at one time it was a NYSE requirement that securities firms be located near the NYSE Clearinghouse, this is no longer so. The proximity requirement became obsolete because electronic processing made it not only possible, but easy for securities firms to clear from any location.

In terms of the possible movement out of New York City, "front-office" operations generally involve considerable face to face communications. However, "back-office" functions, at least at the largest securities firms, have evolved to a point of being highly technologically oriented, and can be located anywhere. At the same time, the energy requirements of these "back-office" functions have increased considerably as have floor space needs. Thus, at large securities firms, there is a trend for front and back-offices to become increasingly separated physically. (Small and medium sized firms usually maintain a close proximity of front and back-offices.)

The fact that most back-office costs, space, taxes, electricity, communications, and labor, are considerably higher in New York City than elsewhere can make a New York location hard to justify for back-office functions. A pattern could develop of large securities firms moving their back-office operations (where a great number of jobs exist) to another location, while retaining other facilities in New York.

The quality of life in a particular location is an important consideration, and taxes, as well as other factors, seem to place New York at a considerable disadvantage in this respect. Finally, if some major firms move out of New York, the critical mass, on which so much of the City's attraction depends, would be threatened and could start to gather elsewhere.

However, for most of the major securities firms, their lease and other real estate commitments make a near-term complete withdrawal from New York highly unlikely. Further, when securities companies look at their competitors' long-term leases and realize that these firms will retain at least a portion of their operations in New York, competitive forces will pressure them to also remain in the City. There are a number of other strong competitive reasons which would make any large-scale withdrawal from New York highly unlikely for any major firm.

No other location can fully substitute for New York. The business revolves around far more than simply the electronic trading of securities. It requires both qualitative and quantitative information and meeting and communicating with other professionals is an indispensible way of obtaining this information. No other location offers the richness in securities industry professionals as does New York. Moreover, the finest in related professional services, such as law, accounting and banking are also in New York. Thus, securities firms are in New York partly because they can get rapid access to the types and quality of information needed. There is even a reasonably effective mass transportation system so that employees who live in close proximity to work can commute easily. For good reasons, while other industries have left metropolitan areas and gone to corporate parks or elsewhere, the securities industry has essentially remained in New York.

While New York City had a decline in population in recent years, it gained in the age group 25-34, the young urban professionals who will likely have more wealth in the future. In Manhattan, this 25-34 age group with a college education had a 12% increase in number from 1970 to 1980. Over 33% of the Manhattan population had four or more years of college by 1980. That education generally translates into affluence in Manhattan is seen by the fact that 8 of the 15 wealthiest individual neighborhoods in the U.S. are located there. This is certainly an important factor in keeping securities firms based in New York.

One important trend with possibly negative consequences for the continued concentration of the securities industry in New York City is the tendency toward more mergers and acquisitions.9/ To the extent that the acquiring firm is based outside of New York, some activities and services may leave the Metropolitan area. However, it is unlikely that such combinations would vacate New York entirely. Moreover, countering this trend is a reversal of the process whereby combinations in the industry bring services to the City. For example, purchases of regional securities firms by National Full Line houses or New York based firms result in greater activity in New York.

9/Concentration, as measured by total revenues and total capital, increased in 1984 resuming an upward trend which was only interrupted in 1983 when favorable market conditions attracted additional firms into the industry. For instance, the top 25 firms accounted for 71.6 percent of total capital in 1983 compared to 64.6% in 1979.

The New York based securities industry will continue to be an important factor in the State and City into the foreseeable future. So long as this trend continues, New York State and City will benefit from the tax receipts and other funds expended by the securities industry. As in any symbiotic relationship, the securities industry will also benefit from the wealth of talented individuals in other professions that live in New York and assist in the everyday business of the securities industry.

Yet, a 1977 study, similar to this one, characterized the industry "as being like a precious gem - small in size but with value beyond expectations. New York may believe this; certainly other states trying to attract parts of the industry do."

Increasingly, customer bases are growing outside of New York City. Furthermore, non-New York Exchanges, both in and outside the U.S., (i.e. Midwest Stock Exchange, London Stock Exchange, etc.) continue to increase their current business and capacity. To keep New York as the "financial center of the world", the City and State must form a partnership with the securities industry that will benefit all parties concerned.

Allan Young
Syracuse University

David Strongin
Research Associate

SECURITIES INDUSTR

	June 1985	YE
AVERAGE DAILY SHARE VOLUME ON		
NYSE (MILS.)*	105.9	
AMEX (MILS.)*	7.1	
NASDAQ (MILS.)*	80.7	
REGIONAL EXCHANGE (MILS.)*	N/A	
DOLLAR VALUE OF SHARES TRADED ON		
NYSE (MILS.)	76,465	47
AMEX (MILS.)	1,864	1
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,874	4
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	14,261	9
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	52.0	
CONTRACTS TRADED (THOUS.)		
CBOE OPTIONS	11,489	7
AMEX OPTIONS	2,574	1
COMMODITY	13,179	7

* *MONTHLY AVERAGE*

N/A - Data not available

STATISTICS

VOLUME

R-TO-DATE 1985	June 1984	YEAR-TO-DATE 1984	% CHG. Y-T-D 1985 - 1984
107.8	85.9	91.1	18.3
8.3	5.1	6.0	38.3
79.6	53.7	58.3	36.5
N/A	14.1	14.1	- - -
2,973	58,433	388,027	21.9
2,796	1,366	10,245	24.9
1,549	5,586	41,238	0.8
4,393	11,987	80,613	17.1
51.5	51.2	49.8	- - -
,685	10,183	59,197	19.4
,586	2,430	17,459	(5.0)
,400	13,209	77,538	1.1

YIELDS
(MONTHLY AVERAGES)

	June 1985	June 1984	Basis Point Change June 85 - June 84
BOND BUYER INDEX (20 BOND)	8.69	10.7	(201)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	10.94	13.55	(261)
Baa CORPORATE	12.40	15.05	(265)
RATIO Aaa CORPORATES TO Baa CORPORATES	.88	.90	(2)
MUNICIPAL BOND YIELD (MOODY'S)	8.69	10.67	(198)

PRICES
(END OF MONTH)

	June 1985	June 1984	% Change June 85 - June 84
DOW JONES INDUSTRIALS	1335.46	1132.40	17.93
STANDARD & POOR'S 500	191.85	153.18	25.24
NYSE COMPOSITE	111.11	88.38	25.72
AMEX MARKET VALUE INDEX	230.89	200.08	15.40
VALUE LINE COMPOSITE	200.35	172.74	15.98
NASDAQ COMPOSITE	296.20	239.65	23.60

UNDERWRITING

	First Half 1985	First Half 1984	First Half 1985 - 1984
CORPORATE FINANCING (Gross New Issues-Dollars in Billions)			
Total	57.5	33.2	73.2
Common Stock	11.1	4.3	158.1
# of Common Stock Issues	331	298	11.1
Preferred Stock	3.1	2.2	40.9
# of Preferred Stock Issues	48	34	41.2
Corporate Debt	43.2	26.7	61.8
# of Corporate Debt Issues	581	320	81.6
MUNICIPAL FINANCING (Gross New Issues-Dollars in Millions)			
Total	13,726	10,685	28.5
Notes	2,805	3,790	(26.0)
Bonds	10,921	6,895	58.4

MARGIN DEBT

	1985 June	1984 June	% Change June 85 - June 84
MARGIN DEBT OUTSTANDING ($MILS)	25,260	23,450	7.7
NET CHANGE IN MARGIN DEBT ($MILS)	1,810	5,520	67.2
% OF ACCOUNTS WITH EQUITY UNDER 40%	10	12	- - -

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	First Quarter 1985	Yr.-To-Date 1985	First Quarter 1984	Yr-To-Date 1984	% Change 4th Q.1985 4th Q.1984	Yr.-To-Date % Change 1985 - 1984
REVENUE						
SECURITIES COMMISSION INCOME	$2,167	$2,167	$1,972	$1,972	9.9%	9.9%
TRADING PROFITS	2,345	2,345	1,947	1,947	20.4	20.4
UNDERWRITING	700	700	553	553	26.6	26.6
TOTAL REVENUE	8,970	8,970	7,944	7,944	12.9	12.9
TOTAL EXPENSES	8,037	8,037	6,947	6,947	15.7	15.7
NET INCOME BEFORE TAXES	933	933	497	3,497	87.7	87.7
PERCENT OF FIRMS SHOWING LOSS	17.1%	17.1%	31.3%	31.3%	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
The New York Securities Industry: Its Contribution: To New York State and City	This recent study, conducted by Professor Allan Young of Syracuse University, concludes that the New York securities industry has a significant impact on the State and City economies. For instance, the study finds that the industry contributes directly and indirectly almost 10% of all taxes collected by the City and State. Additionally, one in six private sector jobs was created by the securities industry.	Publications Department SIA $30 Members, $50 Others
Comparison of Individual Taxation of Capital Gains on Portfolio Stock Investment in Seventeen Countries	SIA/Arthur Andersen study summarizes and discusses major differences in tax treatment of capital gains. Despite major changes, the U.S. tax treatment of capital gains is still generally harsher than that of other countries. Quick reference tables comparing tax rates and holding period in eleven major industrial countries and Pacific Basin.	Publications Department SIA $10 per copy
Securities Industry Yearbook 1985-86	Sixth annual edition of vital statistics on over 500 SIA member firms and industry. This 640-page hardcover book includes: rankings of firms, directory of members and industry and market data.	Yearbook Department SIA $50 Members $85 Others
Same Day Funds Settlement For Securities Transactions: A Research Report	Report of Task Force created by FISC to analyze the business issues affecting conversion to a uniform Same Day Funds Settlement environment for all securities transactions. Five-part book includes: 1. Executive summary; 2. History; 3. Description of current settlement practices; 4. Current system issues; and 5. Overview of findings and conclusions.	SIA Publications Department

"Banks and nonbanks: The horse race continues"	Article examines competition in financial services over the past few years and analyzes how the financial services operations of non-deposit-based firms have fared relative to each other. Of several concluding observations, the following is deemed the "safest": the banking industry has shown an amazing degree of resiliency in the face of change.	Economic Perspectives Federal Reserve Bank of Chicago
"First Half 1985 Corporate Finance Rankings"	Comprehensive rankings of top 15 book managers by: worldwide, domestic, and Euro-market underwritings; underwriting commitments; and various types of instruments. Reviewing first half underwriting volume since 1981 finds the all issues category in 1985 just shy of 1983's record, $59.0 billion versus $57.5 billion.	Investment Dealers' Digest 7/8/85
"The Case for Ending the Capital Gains Tax"	Author explores the case against the capital gains tax on both economic and equity grounds. He details strong reasons for going further than just advocating a lower rate or indexing capital gains.	Financial Analysts Journal May-June 1985
"What will the bank dicks do now?"	Quick review and assessment of current status of the U.S. banking system. Authors' solution: Deregulate all the way, with risks to match. If left to function freely the market can take care of irresponsible madmen long before regulators can stop them.	Forbes 7/1/85
"Major Tax Proposals Before the 99th Congress"	Report summarizes the major "revenue neutral" tax restructuring plans and revenue-raising tax proposals that have emerged from the Administration and Congress in 1985. Significant features affecting both individuals and business are highlighted in concise format.	American Council for Capital Formation 1850 K Street, N.W. Washington, D.C. 20006
"Marathon Markets"	Article reviews pros and cons on 24-hour markets from viewpoints of exchanges, regulators and brokers.	Registered Representative July 1985